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Docket Entries

No. 400-59

ESTATE OF JOSEPH P. GRACE, ET AL.

v.

THE UNITED STATES

I, Frank T. Peartree, Clerk, United States Court of Claims, certify that the items contained herein constitute the record as filed in this Court in the above cause. These papers, for transmittal to the Supreme Court of the United States at Defendant's request, are as follows:

Originals of:

1959 Sept. 24	Plaintiff's petition.
1960 Feb. 10	Plaintiff's more definite statement.
March 8	Defendant's answer to petition.
May 10	Plaintiff's reply to set-off.
1963 Aug. 2	Plaintiff's first amended petition.
Aug. 19	Memorandum of pretrial conference, together with Pltf's Exs. Nos. 1 to 6, 7A,B, and 8 to 30 incl., Deft's Exs. Nos. 1 to 5 incl., and Commr's Exs. Nos. 1 and 2.
Sept. 5	Deft's answer to first amended petition.
Sept. 23	Deft's first amended answer to first amended petition.
Nov. 4	Petition of Michael P. Grace, II, Individually.
Nov. 4	Petition of Janet Maureen Grace, etc.
Dec. 4	Deft's answer to petition of Michael P. Grace, II, Individually.
Dec. 4	Deft's answer to petition of Janet Maureen Grace, etc.
Dec. 12	Transcript of testimony (5 vols.), hearing at New York, N.Y., Oct. 28-Nov. 1, 1963, together with Pltf's Exs. Nos. 31 to 36, 38 to 45, 47 to 62, 63A, B, & 64 to 68 incl., and Deft's Exs. Nos. 6, 7 & 8.

1965	
Jan. 29	Stipulation of facts.
Jan. 29	Plaintiff's motion to supplement the record (see face of motion for Allowance).
Jan. 31	Deft's motion to correct error in transcript of testimony.
Feb. 7	Pltf's opposition to motion to correct error.
Feb. 18	Deft's response re motion to correct error.
Feb. 24	Commr's order re motion to correct error in transcript.
May 15	Stipulation correcting transcript.
May 15	Stipulation correcting additional errors in transcript.
July 20	Commr's Recommended Opinion, Findings & Conclusion of law.
1966	
March 25	Court order remanding case to Commr. for further proceedings.
April 25	Plaintiff's motion for rehearing & brief.
May 10	Defendant's response to motion for rehearing.
June 10	Court order denying motion for rehearing.
June 24	Memorandum of pretrial conference.
Aug. 16	Transcript of testimony (1 vol.), hearing at New York, N.Y., on July 11, 1966, together with Commr's. Exs. 3 to 22 incl.
Oct. 24	Stipulation of facts, together with Commr's. Exs. Nos. 23 to 47 incl., and 47A.
Nov. 3	Commr's. order admitting documents in evidence.
Dec. 2	Stipulation changing transcript of testimony (attached to transcript).
1967	
Feb. 23	Supplemental Commr's. recommended opinion, with additional findings.
1968	
April 19	Opinion of the Court, Per Curiam, with Findings of Fact and Conclusion of Law. Dissenting opinion by Judge Davis in which Judge Nichols joins.
June 28	Court order entering money judgment.
July 3	Court order correcting caption of Money Judgment Order.

IN TESTIMONY WHEREOF I HAVE hereunto set my hand and affixed the seal of the Court of Claims at Washington City this 30th day of July, A.D., 1968.

(s) FRANK T. PEARTREE,
Clerk, United States Court of Claims.

IGLEHART TRUST (DEFT. EX. 4)

First: To hold the same in trust during the life of my wife, Aida B. Iglehart, and to pay the entire net income therefrom to her during her life, together with any amounts of the principal of the said trust, up to and including the whole thereof, which she may at any time or from time to time, by an instrument in writing delivered to the Trustee, direct to be paid to her.

Second: Upon the death of my said wife, to dispose of the balance of the said trust fund then remaining in its hands, together with all unexpended income thereon, to or for the benefit of such of our issue and/or myself as my said wife may by will or deed nominate and appoint to receive the same, or in default of effective appointment thereof, to pay the same to our issue then surviving in equal shares per stirpes, or in default of such issue, to pay the same to those person who would be entitled thereto if I had died at the date of death of my said wife a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I reserve the right during my life, to direct the Trustee to retain any investment at any time held by it hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds, or other property, real or personal, in which the trust fund or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further reserve the right to direct the exchange of any property, real or personal, held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property, and through the voting of proxies issued to me and/or my nominees by authority hereof, to manage and control any corporation the stock of which may at any time be held hereunder. The Trustee is hereby specifically released from all liability for any loss arising from any action taken or omitted to be taken by it at

my direction and from any action taken or omitted to be taken by me and/or my nominees pursuant to any proxy or proxies issued at my direction and with respect to any corporation controlled by me, the stocks, bonds or other securities of which may at any time be held hereunder.

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustee for that purpose.

* * * * *

Seventh: I direct that as compensation for its services in the administration of this trust the Trustee shall be entitled to receive commissions computed and paid as follows:

1. Commissions on principal upon the receipt by it of any property deposited with it hereunder, computed upon the market value of such property at the time of the delivery thereof to it, at the following rates:

    1% on all amounts not exceeding $125,000.
    ¾% on all additional amounts not exceeding $125,000.
    ½% on all additional amounts in excess of $250,000.

The amount of such commissions payable upon the delivery to it of the property described in Schedule "A", hereto annexed, is hereby fixed at $3,463.81.

2. Commissions on principal at the same rates upon the delivery by it of all or any part of the property constituting the principal of the trust to those entitled thereto hereunder, computed upon the market value of the property so delivered at the time of such delivery, except that no such commissions shall be payable with respect to any amounts of principal which Aida B. Iglehart may pursuant to the provisions of Clause "First" hereof direct be paid to her within seven years of the date hereof.

3. In computing principal commissions on any property delivered to the trustee, the scale of rates above specified shall be applied as though the aggregate principal then and theretofore delivered had been delivered at one time, the property then delivered to be valued at its then market value and all property theretofore delivered to be considered to be of its market value at the time or times of the delivery thereof. In computing commissions on principal delivered by the trustee the scale of rates shall be applied in like manner.

4. Commissions of 2% on income to be deducted annually from the income.

* * * * *

Delivery of this instrument and of the property described in Schedule "A" hereto annexed in the City of New York is hereby acknowledged and the foregoing Trusteeship is accepted this 9th day of February, 1931.

GRACE NATIONAL BANK OF NEW YORK,

Attest: (S) ALAN ROSS,

[SEAL] *Trust Officer.*

STATE OF NEW YORK,
County of New York, ss:

On this 9th day of February, 1931, before me personally came Alan Ross, to be known, who being by me duly sworn did depose and say that he resides at 1964 Haring Street, Brooklyn, New York, that he is the Trust Officer of Grace National Bank of New York, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation and that he signed his name thereto by like order.

(s) H. NICKEL,

Notary Public.

GRACE TRUST (DRAFT) (COMMISSIONER'S Ex. 13).

First: I direct the said Trustees to hold the same in trust during the life of my wife, Janet Grace, and to pay the entire net income therefrom to her during her life, together with any amounts of the principal of the said trust, up to and including the whole thereof, which she may at any time or from time to time, by an instrument in writing delivered to the Trustees, direct to be paid to her.

Second: I direct the said Trustees, upon the death of my said wife, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such of our issue and/or myself as my said wife may by will or deed nominate and appoint to receive the same, or in default of appointment thereof, to pay the same to our issue then surviving in equal shares her stirpes,

or in default of such issue, to pay the same to those persons who would be entitled there to if I had died at the date of death of my said wife a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I reserve during my life and I give to my said wife after my death the right to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property, real or personal, in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further reserve during my life and I give to my said wife after my death the right to direct the exchange of any property, real or personal, held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property, and through the voting of proxies issued to me and/or my nominees or after my death to my said wife and/or her nominees by authority hereof, to manage and control any corporation the stock of which may at any time be held hereunder. Any such direction made by me or after my death by my said wife shall be in writing and the Trustees are hereby specifically released from all liability for any loss arising from any action taken or omitted to be taken by them at my direction or after my death at the direction of my said wife and from any action taken or omitted to be taken by me and/or my nominees or after my death by my said wife and/or her nominees pursuant to any proxy or proxies issued at my direction or after my death at the direction of my said wife, and with respect to any corporation controlled by me or after my death by my said wife, the stocks, bonds or other securities of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing, or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Ninth: I direct that any individual acting as Trustee hereunder shall serve without compensation and that as compensation for its services in the administration of this trust, Grace

National Bank of New York shall be entitled to receive commission computed and paid as follows:

1. Commissions on principal upon the receipt by it of any property deposited with it hereunder, computed upon the market value of such property at the time of the delivery thereof to it, at the following rates:

1% on all amounts not exceeding $125,000.
¾% on all additional amounts not exceeding $125,000.
½% on all additional amounts in excess of $250,000.

2. Commissions on principal at the same rates upon the delivery by it of all or any part of the property constituting the principal of the trust to those entitled thereto hereunder, computed upon the market value of the property so delivered at the time of such delivery.

3. In computing principal commissions on any property delivered to said Trustee, the scale of rates above specified shall be applied as though the aggregate principal then and theretofore delivered had been delivered at one time, the property then delivered to be valued at its then market value and all property theretofore delivered to be considered to be of the market value at the time or times of the delivery thereof. In computing commissions on principal delivered by said Trustee the scale of rates shall be applied in like manner.

4. Commissions of 2% on income to be deducted quarterly from the income.

* * * * *

Delivery of this instrument in the City of New York and of the property described in Schedule "A" hereunto annexed are hereby acknowledged and the foregoing trusteeship is accepted this ——— day of ——————— 1931.

....L.S.

....L.S.

GRACE NATIONAL BANK OF NEW YORK

....

Trust Officer.

STATE OF NEW YORK,
County of New York, ss:

On this ——— day of ————, 1931, before me personally came Alan Ross, to me known, who being duly sworn by me did depose and say that he resides at 1964 Haring Street, Brooklyn, New York; that he is the Trust Officer of Grace National Bank of New York, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of such corporation, and that he signed his name thereto by like order.

....

In the United States Court of Claims

No. 400–59

(Filed July 20, 1964)

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL. v. THE UNITED STATES

OPINION AND FINDINGS OF FACT OF COMMISSIONER

To the honorable the CHIEF JUDGE AND ASSOCIATE JUDGES OF THE UNITED STATES COURT OF CLAIMS:

The following opinion, findings of fact, and recommendation for the conclusion of law are submitted under the order of reference and the order of the court dated November 8, 1963:

OPINION OF COMMISSIONER

The primary question to be decided in this case is whether the Internal Revenue Service acted correctly in adding to the gross estate of Joseph P. Grace, who died on July 15, 1950, the sum of $1,116,888.62, representing the value of a trust that had been created on December 30, 1931.

The Internal Revenue Service purported to act under the authority of Section 811(c) of the Internal Revenue Code of 1939, as amended.[1] That section, at the time of the decedent's death, provided (among other things) that the value of the gross estate of a decedent should be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, "To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * the possession or

[1] When the decedent died on July 15, 1950, the original language of Section 811(c), as found in 53 Stat. at pp. 120–121, had been amended by Section 7(a) of the Act of October 25, 1949 (63 Stat. 891, 894).

enjoyment of, or the right to the income from, the property * * *."

It is clear that under the provisions of the trust of December 30, 1931, the decedent for his lifetime had the right to the income from the income-producing portion of the trust property, and that he was entitled to the possession and enjoyment of the remainder of the trust property. On the other hand, the decedent, at least in form, was not the settlor of the trust, he had not directly "made a transfer" of any property or interest in property to the trust, and, strictly speaking, he had not "retained" any beneficial interest in the trust property but, rather, had obtained such interest by virtue of the instrument creating the trust. The person who executed the instrument creating the trust of December 30, 1931, and who directly transferred to that trust all the property covered by it, was the decedent's wife, Janet Grace. (For the sake of convenience, the trust of December 30, 1931, will usually be referred to hereafter in the opinion as "the Janet Grace trust.")

The defendant contends that the decedent, by himself creating on December 15, 1931, a reciprocal trust which conferred on Janet Grace benefits similar to those which were conferred on the decedent by the Janet Grace trust, furnished consideration for the creation of the Janet Grace trust; and, therefore, that for estate-tax purposes the decedent and Janet Grace should be switched or crossed as settlors and the decedent should be regarded as having been in substance the settlor of the Janet Grace trust. This contention is based upon a judicially developed rule that was first announced in the case of *Lehman* v. *Commissioner*, 109 F. 2d 99 (2d Cir., 1940), *cert. denied* 310 U.S. 637.

The facts in the *Lehman* case were stipulated by the parties. According to the stipulation, two brothers, Harold M. and Allan S. Lehman, owned equal shares in certain stocks and bonds. Harold agreed to transfer his share in trust for Allan and the latter's issue, in consideration of Allan transferring his share in trust for Harold and Harold's issue, and trusts were created in accordance with the agreement. The income from the trust property transferred by Harold was to be paid to Allan for his life, with the remainder to Allan's issue, and Allan had the right to withdraw not to exceed

$150,000 of the principal. Similarly, the income from the trust property transferred by Allan was to be paid to Harold for his life, with the remainder to Harold's issue, and Harold had the right to withdraw up to $150,000 of the principal. Harold later died, and the court was called upon to decide whether trust property transferred by Allan was taxable as part of Harold's estate. This question was answered in the affirmative. The court said (109 F. 2d at pp. 100-101) that Harold, by transferring his share of the stocks and bonds in trust for the benefit of Allan and the latter's issue, had "paid for and brought about" the transfer by Allan of his share of the stocks and bonds in trust for the benefit of Harold and Harold's issue; and, therefore, that Allan's transfer was in substance a transfer by Harold, so as to make the property so transferred part of Harold's taxable estate.

The crucial factor in the *Lehman* case was that, under the agreed facts, Harold Lehman had furnished consideration for—i.e., he had "paid for and brought about"—the transfer of property by Allan Lehman in trust for the benefit of Harold Lehman and the latter's issue. *In re Lueders' Estate*, 164 F. 2d 128, 133–134 (3d Cir., 1947); *Newberry's Estate* v. *Commissioner*, 201 F. 2d 874, 877 (3d Cir., 1953); *McLain* v. *Jarecki*, 232 F. 2d 211, 213 (7th Cir., 1956). In the present case, therefore, it is necessary to determine whether the decedent, by creating the trust of December 15, 1931, was furnishing consideration for—i.e., whether he was paying for—the subsequent creation of the Janet Grace trust on December 30, 1931. This is a question of fact. *Estate of Moreno* v. *Commissioner*, 28 T.C. 889, 891 (1957), *affirmed* 260 F. 2d 389 (8th Cir., 1958). It involves an inquiry into the element of motivation. *Estate of Carter* v. *Commissioner*, 31 T.C. 1148, 1152 (1959).

Unfortunately, it is necessary to rely largely on circumstantial evidence in making the factual determination that is crucial in the disposition of this case, as both the decedent and Janet Grace were dead at the time of the trial. Consequently, it will be necessary to outline in considerable detail the known facts which appear to be pertinent in drawing inferences with respect to the motivation which led the de-

cedent and Janet Grace to create the trusts of December 15 and 30, 1931.

The decedent and Janet Grace were married in August 1908. Five children, three sons and two daughters, were born to them. One of the daughters died in 1935, but the other four children were living at the time of the trial.

The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not thereafter inherit any substantial wealth. However, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers which the decedent made to her, either directly or indirectly. For example, when the decedent on April 5, 1911, paid the purchase price for and acquired a 167-acre farm on Long Island for the purpose of developing it into a homestead for the family, he caused the legal title to be vested in Janet Grace. Thereafter, the decedent proceeded at great expense to convert the acreage into a country estate for use as the family home. The property was called Tullaroan, and it included among the numerous improvements a 65-room colonial-style residence for the family. Tullaroan became the home of the decedent and Janet Grace in about 1911, and it continued to be their home for the remainder of their lives.

There is in the record evidence concerning 24 transfers of property and financial interests by the decedent to Janet Grace during the period between April 19, 1917, and May 10, 1929. One of these transfers involved 3,000 shares of stock in the Ingersoll-Rand Company having a book value of $300,000, and there were 9 additional instances where property having a book value of $100,000 or more was transferred by the decedent to Janet Grace.

The record also contains evidence regarding the creation by the decedent, during the period between August 26, 1920, and June 5, 1930, of 26 trusts for the benefit of his children. While in most instances the properties transferred by the decedent to these various trusts had relatively modest book values, the decedent provided 5 of the trusts with properties having book values in excess of $100,000 for each trust.

In addition, the record contains evidence concerning five instances during the period between August 26, 1920, and March 31, 1929, when Janet Grace made transfers of assets to or for the benefit of the decedent or their children. These incidents involved transfers of properties having book values ranging all the way from $3,860.15 to $613,344.32. It is interesting to note that the largest of these transfers, which was shown by the record to have been a gift from Janet Grace to the decedent, in effect involved a retransfer by Janet Grace to the decedent of property which the decedent had transferred to her in the first instance. What Janet Grace transferred to the decedent in that instance was stock in a personal holding company which had been set up on behalf of Janet Grace to hold valuable corporate shares which the decedent had previously transferred to Janet Grace.

The decedent exercised supervision and control over, and he made the decisions that were involved in the management of, the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or disposition of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument. Therefore, although there is no direct evidence in the record relative to the circumstances that were involved in the transfers of assets by Janet Grace previously mentioned, it is reasonable to infer that such transfers were made by Janet Grace in accordance with plans devised by the decedent.

In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Com-

pany to assist him by handling the details that were involved in carrying out his decisions.

The events that led directly to the creation by the decedent of the trust dated December 15, 1931, and to the creation of the Janet Grace trust on December 30, 1931, began in early December of 1931, when the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company, concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts for the benefit of the family should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with transfers of assets to such trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships. The decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the ownership of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had in his possession drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

Following the conference mentioned in the preceding paragraph, and in accordance with the plan devised by the decedent, he executed on December 15, 1931, a trust instrument which created a trust that will be referred to hereafter in the opinion as "the Joseph Grace trust." William R. Grace, William G. Holloway, and the decedent himself were named in the instrument as trustees of the Joseph Grace trust. The trustees were directed to pay the income from the trust to Janet Grace during her lifetime, and also to pay to her any amounts of the principal which a majority of the trustees might deem advisable. Janet Grace was given the power to designate, by will or deed, the manner in which the trust estate remaining at the time of her death should be distributed to or for the benefit of the decedent and their children.

In connection with the execution of the trust instrument on December 15, 1931, the decedent transferred to the Joseph Grace trust blocks of the capital stock of three corporations, several parcels of real estate, and a one-fourth undivided interest in a certain joint venture which, at the time, owned a tract of land, a number of real estate mortgages, other receivables, cash, and 10,620 shares of common stock in the Ingersoll-Rand Company.

Fifteen days after the creation of the Joseph Grace trust by the decedent, Janet Grace on December 30, 1931, acting in accordance with the plan of the decedent previously mentioned, executed the trust instrument which created the Janet Grace trust. William R. Grace, William G. Holloway, and Janet Grace were named as the trustees of the Janet Grace trust. Under the provisions of this trust, the trustees were to pay the income from the trust property to the decedent during his lifetime, together with any amounts of the principal which a majority of the trustees might deem advisable. Also, the trust instrument directed that, during the life of the decedent, he should be entitled to the use and occupancy of the real property that was included in the trust.

In connection with the execution of the trust instrument referred to in the preceding paragraph, Janet Grace on December 30, 1931, transferred to the Janet Grace trust the family homestead, Tullaroan, and 40 shares of stock in a corporation known as Lundy's Lane Corporation. That corporation was a personal holding company which had been incorporated on behalf of Janet Grace on November 9, 1923. At that time, she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock, and 3,040 shares of W. R. Grace and Company preferred stock, all of which had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of stock in Lundy's Lane Corporation originally owned by Janet Grace, she made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totaling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. After the creation of the

Janet Grace trust on December 30, 1931, Janet Grace continued to own 367 shares of stock in Lundy's Lane Corporation, the decedent owned 100 shares, the Janet Grace trust owned 40 shares, and the five trusts previously created by the decedent for the benefit of his children owned 20 shares each.

The pattern of creating trusts for the benefit of members of the family, and of transferring assets directly to members of the family, continued during the years that followed the creation of the Joseph Grace trust and the Janet Grace trust in December of 1931. Both the decedent and Janet Grace were involved in such actions.

Janet Grace died on December 31, 1937, at the age of 53 years. The Joseph Grace trust terminated with the death of Janet Grace. The estate of Janet Grace filed a Federal estate tax return in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the IRS asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by reductions in the values, as shown on the return, of certain blocks of corporate stock owned by Janet Grace at the date of her death, and by elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned its counter-contentions.

In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in the preceding paragraph, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal

trusts were applicable, it would be the value of the lesser trust (i.e., the Janet Grace trust) that would be taxable as part of the estate of Janet Grace.

The decedent died on July 15, 1950, at the age of 73 years. A Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the decedent's gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent.

Following an examination of the return referred to in the preceding paragraph, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under Section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate. This deficiency, plus assessed interest in the amount of $55,720.08, was paid by the decedent's estate on July 14, 1954.

A claim for refund was subsequently filed with the Internal Revenue Service on behalf of the decedent's estate. Administrative relief was not obtained, and the present action followed.

A very significant fact in connection with the creation of the Joseph Grace trust and the Janet Grace trust was that, as inferred from the evidence in the whole record, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences. These transfers were part of a well-established pattern of

conduct, managed by the decedent, which began as early as 1911, which continued for many years, and which involved numerous transfers of valuable property and financial interests among the members of the family.

It is certainly obvious that the decedent, when he created the Joseph Grace trust on December 15, 1931, was not motivated by any intention to give consideration for, or pay for, the transfer of Tullaroan by Janet Grace to the Janet Grace trust on December 30, 1931, in order that he might obtain the right to the use and enjoyment of the family homestead. As previously indicated, Tullaroan had been the family homestead since about 1911. The decedent had paid the original purchase price for Tullaroan, although the title had been taken in the name of Janet Grace, and the decedent had subsequently provided the funds that were required for the construction of the buildings and other improvements in developing Tullaroan into a country estate (except that an uncle of the decedent bore the cost of making certain additions to the main residence in about 1920). At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan during their lives; and, in fact, they both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust. Consequency, there is no basis in the record for a finding that the decedent created the Joseph Grace trust and transferred property to it in order to induce Janet Grace to transfer Tullaroan to the Janet Grace trust so that the decedent might obtain the right to the use and enjoyment of the family homestead.

It would also be unrealistic to find that the decedent, in creating the Joseph Grace trust on December 15, 1931, intended to furnish consideration for, or pay for, the transfer by Janet Grace of the 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust. That corporation was a personal holding company that had been established on behalf of Janet Grace to hold valuable shares of corporate stock which the decedent himself had previously given to

Janet Grace. Actually, as stated heretofore, the inference to be drawn from the whole record is that the decedent, when he created the Joseph Grace trust and transferred property to it, was not motivated by a desire to obtain any sort of property, or interest in property, from Janet Grace. Rather, he was merely continuing a long-established pattern of conduct, and the immediate motivation was a desire to effect transfers of assets among members of the family before an expected new gift tax became effective.

Conversely, there is no basis in the record for a finding that Janet Grace, in transferring Tullaroan and 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust. Indeed, there is no evidence in the record that Janet Grace even knew about the creation of the Joseph Grace trust by the decedent. *Cf. Hanauer's Estate* v. *Commissioner*, 149 F. 2d 857, 859 (2d Cir., 1945), *cert. denied* 326 U.S. 770. On the basis of the whole record, it is reasonable to infer that Janet Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so; and that if any explanation at all was given to Janet Grace by the decedent, it was merely to the effect that a probable saving in gift tax could be effected if such actions were taken by Janet Grace before the end of 1931.

On the basis of the whole record, therefore, it seems reasonable to find that the decedent, when he created the Joseph Grace trust on December 15, 1931, was not giving consideration for, or paying for, the transfer by Janet Grace to the Janet Grace trust on December 30, 1931, of either Tullaroan or the 40 shares of stock in Lundy's Lane Corporation; and, conversely, that Janet Grace, when she made such transfers to the Janet Grace trust, was not induced or caused to do so by reason of the previous creation of the Joseph Grace trust by the decedent. This conclusion is not negatived by the circumstances that the two trusts were very similar and that they were created as parts of what was essentially a single transaction. *McLain* v. *Jarecki*, *supra*, at p. 213; *cf. Orvis* v. *Higgins*, 180 F. 2d 537, 541 (2d Cir., 1950), *cert.*

denied 340 U.S. 810. This being so, the *Lehman* rule is not applicable to the facts of the present case.

I believe that it would not be in accord with reality, and that it would involve an unduly strained interpretation of Section 811(c) of the Internal Revenue Code of 1939, as amended, to hold that the decedent "made a transfer" of property to the Janet Grace trust.

It is my opinion, therefore, that the Internal Revenue Service acted erroneously in adding to the gross estate of Joseph P. Grace the sum of $1,116,888.62 as representing the value of the Janet Grace trust. I recommend that the court enter a judgment in favor of the plaintiffs on the issue of liability, reserving the determination of the amount of recovery for further proceedings under Rule 47(c).

Findings of Fact

1. This case is a suit for refund of Federal estate taxes and interest thereon paid by the Estate of Joseph P. Grace, Deceased.

2. Joseph P. Grace, the decedent whose estate is here involved (hereinafter sometimes called "the decedent"), and Janet Grace were husband and wife. They were married in August 1908.

3. (a) The following children, born on the dates indicated, are the surviving offspring of the marriage of the decedent and Janet Grace:

Joseph Peter Grace, Jr. (hereinafter sometimes called "Peter"), May 25, 1913.

Michael P. Grace, II (hereinafter sometimes called "Michael"), August 6, 1917.

Janet Maureen Grace (hereinafter sometimes called "Maureen"), December 27, 1924.

Charles MacDonald Grace (hereinafter sometimes called "Charles"), September 13, 1926.

(b) Another child, Nora Grace (hereinafter sometimes called "Nora"), was born to the decedent and Janet Grace. Nora died on August 25, 1935.

4. The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not

thereafter inherit any substantial wealth. However, as indicated in subsequent findings, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers made by the decedent to her.

5. (a) The decedent exercised supervision and control over, and he made the decisions that were involved in the management of the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or disposition of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument.

(b) In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Company to assist him by handling the details that were involved in carrying out his decisions.

6. (a) Beginning in about 1911 and continuing thereafter as long as the decedent and Janet Grace lived, their family homestead was a large country estate known as Tullaroan, which was situated near Lakeville in the town of North Hempstead, Nassau County, Long Island, New York. When Tullaroan was first acquired for the Grace family on April 5, 1911, it consisted of a substantial farmhouse located on approximately 167 acres of land. The decedent promptly undertook the development and improvement of the property into a homestead for his family. The improvements ultimately included a 65-room colonial-style house for the family residence, several smaller dwellings for members of the household staff, an indoor tennis court, two swimming pools, a polo field, three greenhouses, a garage, a stable, a dog kennel,

two cow barns, a bull pen, a pig sty, two chicken houses, and a well and pumphouse to provide a water system for the property. The grounds around the main house were extensively terraced and lanscaped.

(b) The decedent paid the purchase price for Tullaroan when it was acquired on April 5, 1911, although title to the property was taken in the name of Janet Grace. The decedent also paid for the construction of the buildings and other improvements at Tullaroan, except that the decedent's uncle, Michael P. Grace, paid for substantial additions to the main residence in about 1920.

7. (a) During the period between April 19, 1917, and July 20, 1926, the decedent transferred property and financial interests to Janet Grace, as indicated in the following table:

Date of transfer	Property transferred	Book value
4-19-17	3,000 sh. Ingersoll-Rand Co.	$300,000.00
5-12-17	1,600 sh. W. R. Grace & Co. 2d. Pfd.	160,000.00
5-12-17	1,600 sh. W.R. Grace & Co., Common	160,000.00
6-14-18	250 sh. Ingersoll-Rand Co.	25,000.00
6-14-18	1,000 sh. W. R. Grace & Co., Common	100,000.00
3-27-19	20,000 sh. Grace Bros. & Co., Ltd	48,686.00
3-27-19	1,106 sh. W. R. Grace & Co., 2d. Pfd.	114,100.00
3-27-19	1,500 sh. Ingersoll-Rand Co.	150,000.00
12-31-19	1,000 sh. W. R. Grace & Co., Common	100,000.00
12-31-19	1,000 sh. Ingersoll-Rand Co.	100,000.00
12-31-20	Smoketown Property	4,409.73
5-3-22	325 sh. Ingersoll-Rand	32,500.00
6-5-22	50 sh. A&P SS Co., Common	5,000.00
6-6-22	334 sh. W. R. Grace & Co., 2d. Pfd.	33,400.00
11-[illegible]-23	756 sh. W. R. Grace & Co., Pfd.	75,[illegible]00.00
11-8-23	50 sh. The Evergreens	6,485.00
11-8-23	150 sh. Terminal Whse. Co.	9,104.46
11-8-23	400 sh. National City Bank of N.Y.	113,148.50
11-8-23	100 sh. National City Co.	no value.
11-8-23	66 sh. Lincoln Safe Deposit Co.	12,660.00
12-[illegible]-23	Cash	25,000.00
7-20-26	Cash (loans treated as gifts)	135,000.00
7-20-26	Tennis Court Building	97,725.97

(b) On May 10, 1929, the decedent deeded to Janet Grace a large tract of land known as the Arthur Farm Property, which was located immediately adjacent to Tullaroan. At the time of the transfer, this property had a book value of $72,715.18.

8. (a) During the period between August 26, 1920, and June 5, 1930, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
8-26-20	8,000 sh. Grace Bros. & Co., Ltd.	Peter	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd.	Michael	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd.	Nora	$97.37
1-15-25	8,000 sh. Grace Bros. & Co., Ltd.	Maureen	2[illegible],000.00
2- 2-26	1,000 sh. Grace Bros. & Co., Ltd.	Peter	3,000.00
2- 2-26	1,000 sh. Grace Bros. & Co., Ltd.	Michael	3,000.00
2- 2-26	1,000 sh. Grace Bros. & Co., Ltd.	Nora	3,000.00
2-17-26	1,000 sh. Grace Bros. & Co., Ltd.	Maureen	3,000.00
7- 9-26	666 sh. Ingersoll-Rand Co.	Maureen	22,282.82
12- 1-27	800 sh. Ingersoll-Rand Co.	Nora	18,452.68
1- 5-28	966 sh. Ingersoll-Rand Co. 166 sh. W. R. Grace & Co., Common. 9,000 sh. Grace Bros. & Co., Ltd. 15 sh. The Evergreens. $5,000 Lake Shore Michigan, So. 4% 1928. 5,000 United Kingdom 5½% 1937. 2,000 Mead Pulp & Paper 6% 1934. 1,000 Ingersoll-Rand Co. 5% 1935. 1,000 Grace Nitrate Co. 6% 1942. 3,000 Terminal Warehouse 5% 1942.	Charles	60,210.44
4-30-29	60 sh. United Aircraft & Transport Corp.	Peter	1,800.60
4-30-29	60 sh. United Aircraft & Transport Corp.	Michael	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp.	Nora	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp.	Maureen	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp.	Charles	1,800.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Janet	750.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Charles	750.00
4- 4-30	20 sh. Lundy's Lane Corp.	Peter	107,281.71
4- 4-30	20 sh. Lundy's Lane Corp.	Michael	107,281.71
4- 4-30	20 sh. Lundy's Lane Corp.	Nora	107,281.71
4- 4-30	20 sh. Lundy's Lane Corp.	Maureen	107,281.71
4- 4-30	20 sh. Lundy's Lane Corp.	Charles	107,281.71
6- 5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Peter	750.00
6- 5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Michael	750.00
6- 5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Nora	750.00

9. During the period between August 26, 1920, and March 31, 1929, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children.

Date	Book value	Description
8-26-20	$100,000.00	20,000 shares Grace Bros. & Co., transferred to account of children.
12-21-24	25,000.00	Transfer to Joseph P. Grace and Janet Grace, as Trustees for Maureen.
9- 1-26	10,000.00	Joseph P. Grace, loan-gift.
1- 5-28	3,860.15	35 shares, The Evergreens, gift Joseph P. Grace.
3-31-29	613,344.32	Gift to Joseph P. Grace, 200 shares of Lundy's Lane Corp.

10. In early December of 1931, the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company (see finding 5(b)), concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with the transfers of assets to the trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships; and the decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the ownership of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had with him drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

11. (a) Following the conference with J. Morden Murphy referred to in finding 10, and in accordance with the plan of the decedent mentioned in that finding, the decedent on December 15, 1931, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Joseph Grace trust." This trust instrument provided in part as follows:

> I, Joseph P. Grace, River House Rd., Manhasset of the County of Nassau, State of New York, hereby constitute William R. Grace, Old Westbury Rd., Old Westbury; William G. Holloway, Store Hill Rd., Old Westbury; and Joseph P. Grace, Power House Rd., Manhasset and their successors Trustees of the property described in Schedule "A" heretunto annexed, which property I have transferred, delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations.
>
> *First:* I direct the said Trustees to hold the same in trust during the life of my wife, Janet Grace, and to pay the entire net income therefrom to her during her life, together with any amounts of the principal of the

said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time in their sole discretion deem advisable.

Second: I direct the said Trustees, upon the death of my said wife, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such one or more of our issue and myself as my said wife may by will or deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as she may provide in such appointment, or to the extent that she may not effectively appoint the same, to pay the same to our issue then surviving in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said wife a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I reserve during my life and I give to my said wife after my death the right to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property, real or personal, in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further reserve during my life and I give to my said wife after my death the right to direct the exchange of any property, real or personal, held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property, and through the voting of proxies issued to me and/or my nominees or after my death to my said wife and/or her nominees by authority hereof, to manage and control any corporation the stock of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the individual Trustees herein named or of any of their successors, I direct that my said wife, or, if she be dead, the remaining Trustees shall have

the power to name an individual or a bank or corporation empowered by law to act in such a capacity, to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, the decedent on December 15, 1931, transferred to the Joseph Grace trust the following assets, previously selected by the decedent as indicated in finding 10: 300 shares of the capital stock of the Gilchrest Realty Corporation; 329⅛ shares of the capital stock of Belgrave Realty, Inc.; 150 shares of the capital stock of the Thomaston Corporation; certain real estate referred to as Thomaston Cottage #5, Bell-Brookhaven-Lot 26, 310–312 East 37th Street, and the Yaphank property; and a one-fourth undivided interest in a certain joint venture known as the Grace Harbor Account.

(c) The Gilchrest Realty Corporation was a real estate development company whose assets consisted principally of improved and unimproved properties located on Long Island, New York, including unimproved lots held for sale and improved commercial rental properties, most of which represented the remaining unsold portion of a 58-acre tract of land, with buildings, known as Smith Farm, which the corporation had acquired at the time of its organization in 1916 and had subsequently subdivided, sold lots out of, constructed additional buildings and improvements upon, and otherwise dealt with, plus real estate mortgages derived from sales of such property. The 300 shares of Gilchrest Realty Corporation transferred by the decedent to the Joseph Grace trust represented 20 percent of the 1,500 shares then outstanding, and were all of the shares of the Gilchrest Realty Corporation which the decedent owned. The decedent had acquired 294 of these shares by gift from Lillius Grace, his mother, in 1917, had received 1 share from her estate in 1923, and had purchased 5 shares in or about 1917. The decedent received no dividends on this stock while it was held by him, nor were any dividends received on this stock by the Joseph Grace trust from the date of the creation of that trust to its termination on December 31, 1937.

(d) Belgrave Realty, Inc., was a real estate development corporation whose assets consisted principally of the remain-

ing unsold portion of a 59-acre tract of land located on Long Island, New York, and known as Allen Farm, which the corporation had acquired in 1916 and had subsequently subdivided and sold lots out of, as well as mortgages and cash derived from the sale of lots. The 329⅛ shares of Belgrave Realty, Inc., which the decedent placed in the Joseph Grace trust represented 21.94 percent of the 1,500 shares then outstanding, and were all of the shares of Belgrave Realty, Inc., which the decedent then owned. The decedent had acquired 100 shares of this stock from his mother's estate in 1926, 166⅔ shares were distributed to him by a holding company in 1927, and 50 shares and 12½ shares were received in 1929 and 1930, respectively, from the estate and a testamentary trust under the will of his uncle, Michael P. Grace. No dividends were received by the decedent from Belgrave Realty, Inc., while he held this stock, but the Joseph Grace trust received certain "extraordinary dividends" thereon in 1933 and 1937.

(e) The Thomaston Corporation was a holding or investment company whose assets consisted of common and preferred stocks of various corporations. The 150 shares of Thomaston Corporation stock which the decedent transferred to the Joseph Grace trust on December 15, 1931, represented 19.74 percent of the 760 shares then outstanding, all of which were owned by the decedent prior to that transfer in trust. The decedent had acquired all of the 760 shares on November 8, 1923, in exchange for securities transferred to the corporation. The 150 shares of Thomaston Corporation were distributed to Janet Grace on April 27, 1932, upon directions from the decedent and one of the other two trustees, "in accordance with the power conferred upon them by the first clause of the indenture of 12/15/31." On the same date, Janet Grace made a gift of the same 150 shares of Thomaston Corporation to the decedent.

(f) The real properties referred to as Bell-Brookhaven-Lot 26 and the Yaphank property were unimproved lands situated in the town of Brookhaven, Suffolk County, Long Island, New York. The Yaphank property was a large tract of about 1,000 acres. Bell-Brookhaven-Lot 26 consisted of a long, narrow strip between Great South Bay and the Atlantic Ocean, about 125 feet in width and running

about 1,251 feet in length between the two bodies of water. Bell-Brookhaven-Lot 26 had been purchased by the decedent on December 21, 1926, at a cost of $56,905.32. The Yaphank property had been purchased by the decedent on August 24, 1928, at a cost of $69,532.50.

(g) The properties known as Thomaston Cottage #5 and 310–312 East 37th Street were improved rental properties having market values of $3,750 and $47,500, respectively, at the date of the creation of the Joseph Grace trust. Thomaston Cottage #5 had been owned by the decedent since July 6, 1893, when he acquired it by deed from his mother, Lillius Grace. The 310–312 East 37th Street buildings had been purchased by the decedent on May 2, 1928, at a total cost of $65,737.16.

(h) The Grace Harbor Account was a real estate development joint venture formed on October 1, 1927, between the five beneficiaries under the will of the decedent's mother, Lillius Grace, and the Gilchrest Realty Corporation, whereby certain real estate belonging to the estate was transferred to the corporation, which undertook to develop, improve, and sell the property, accounting to the beneficiaries for the proceeds thereof; and there was also transferred to the corporation, for the purpose of financing development costs, certain mortgages and 13,275 shares of the common stock of Ingersoll-Rand Company, in which each of the beneficiaries owned an undivided one-fifth interest. The decedent originally owned an undivided one-fifth interest in the Grace Harbor Account; but one of the five owners withdrew in 1928, leaving the decedent owning a one-fourth undivided interest, which he placed in the Joseph Grace trust. At the time of the creation of the Joseph Grace trust, the assets of the Grace Harbor Account consisted principally of the unsold (or sold and reacquired) portion of a tract of land known as Gracefield or Grace Harbor, a number of real estate mortgages, other receivables and cash, and 10,620 shares of Ingersoll-Rand common stock. Gracefield or Grace Harbor originally consisted of about 177 acres, but this tract had been developed and portions of it had been sold prior to the creation of the Joseph Grace trust.

12. (a) On December 30, 1931, Janet Grace, acting in accordance with the plan of the decedent mentioned in finding

10, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Janet Grace trust." The trust instrument provided in part as follows:

> I, JANET GRACE, of the County of Nassau, State of New York, hereby constitute WILLIAM R. GRACE, WILLIAM G. HOLLOWAY and JANET GRACE and their successors Trustees of the property described in Schedule "A" hereunto annexed, which property I have transferred and delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations:
>
> *First:* I direct the said Trustees to hold the same in trust during the life of my husband JOSEPH P. GRACE and to pay the entire net income therefrom to him during his life together with any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time deem advisable. I further direct that during the life of my said husband he shall be entitled to the use and occupancy of the real property described in Schedule "A" hereunto annexed or such part thereof as shall not have been conveyed to him in fee pursuant to the provisions of the clause "First".
>
> *Second:* I direct the said Trustees, upon the death of my said husband, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such one or more of our issue and myself as my said husband may by Will or Deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as he may provide in such appointment, or to the extent that he may not effectively appoint the same, to pay the same to our issue then surviving, in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said husband a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.
>
> *Third:* I give to my said husband the right during his life and I reserve the right after his death to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property real or personal in which the trust estate or any reinvestment thereof shall be invested and to direct the

issuance of voting proxies under any stocks held hereunder. I further give to my said husband the right during his life and I reserve the right after his death to direct the exchange of any property, real or personal held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property and through the voting of proxies issued to my said husband and/or his nominees or after his death to me and/or my nominees by authority hereof, to manage and control any corporation, the stock of which may at any time be held hereunder. Any such direction made by my said husband or after his death by me shall be in writing and the Trustees are hereby specifically released from all liability for any loss arising from any action taken or omitted to be taken by them at the direction of my said husband or after his death at my direction and from any action taken or omitted to be taken by my said husband and/or his nominees or after his death by me and/or my nominees pursuant to any proxy or proxies issued at his direction and with respect to any corporation controlled by him, the stocks, bonds or other securities of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the Trustees herein named or of any of their successors, I direct that my said husband, or if he be dead, the remaining Trustees shall have the power to name an individual or a bank or corporation empowered by law to act in such a capacity to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, Janet Grace on December 30, 1931, transferred to the Janet Grace trust the following assets, previously selected by the decedent as indicated in finding 10: Tullaroan (see finding 6) and 40 shares of stock in a certain corporation known as Lundy's Lane Corporation.

(c) At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan

during their lives; and, in fact, both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust.

(d) Lundy's Lane Corporation was a personal holding company incorporated on behalf of Janet Grace on November 9, 1923, at which time she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock, and 3,040 shares of W. R. Grace and Company second preferred stock. All of the latter securities had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of Lundy's Lane Corporation stock originally owned by Janet Grace (which were all of the outstanding shares of the corporation at all times material to this litigation), Janet Grace made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totaling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. On December 30, 1931, immediately prior to the creation of the Janet Grace trust, Janet Grace owned 407 shares of the stock of Lundy's Lane Corporation; and after the transfer of 40 shares to that trust on December 30, 1931, the stock was held as follows:

Janet Grace trust	40 shares
Decedent	100 shares
Five trusts for children (20 shares each)	100 shares
Janet Grace	367 shares
Total stock outstanding	607 shares

(e) There is nothing in the evidence to indicate that Janet Grace, when she signed the instrument creating the Janet Grace trust and transferred property to that trust, was aware that the decedent had created the Joseph Grace trust.

13. The similarity between the trust instruments creating the Joseph Grace trust and the Janet Grace trust, as indicated in findings 11(a) and 12(a), also obtained with respect

to the portions of the respective trust instruments which have been omitted from the findings.

14. At the time of the creation of the Janet Grace trust on December 30, 1931, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,633,113.26 on December 31, 1931, after the creation of the Janet Grace trust.

15. In connection with the creation of the Joseph Grace trust and the Janet Grace trust, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences.

16. (a) Subsequent to the creation of the Joseph Grace trust on December 15, 1931, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
12-28-35	$20,000.00 Gilchrest Realty Corp., 2½% Notes due April 1, 1921.	Maureen	$20,000.00
12-28-35	Two parcels of real property in Manhasset, Nassau Co., N.Y.; 112 sh. W. R. Grace & Co., Pref.; 238 sh. W. R. Grace & Co. Pref.	Maureen and Charles.	66,955.00
12-31-35	6 sh. Lundy's Lane Corp	Michael	83,258.46
12- 2-37	100 sh. Ingersoll-Rand Co	Peter	9,450.00
12- 2-37	100 sh. Ingersoll-Rand Co	Michael	9,450.00
12- 2-37	100 sh. Ingersoll-Rand Co	Maureen	9,450.00
12- 2-37	100 sh. Ingersoll-Rand Co	Charles	9,450.00
2-21-38	3% interest in real property situated at Northwest, Town of Easthampton, Suffolk Co., N.Y.	Maureen and Charles.	7,307.03
11-24-39	4,000 sh. Ingersoll-Rand Co	Maureen and Charles.	197,134.48

(b) In addition to creating the trusts referred to in paragraph (a) of this finding, the decedent subsequent to December 15, 1931, transferred assets directly to his children, as follows:

Date	Property transferred	Transferee	Book value
10-20-37	1/2 share Lundy's Lane Corp.	Peter	
10-20-37	1/2 share Lundy's Lane Corp.	Michael	$10,728.17
10-20-37	1/2 share Lundy's Lane Corp.	Maureen	
10-20-37	1/2 share Lundy's Lane Corp.	Charles	
9-11-39	225 sh. W. R. Grace & Co., Common	Peter	
9-11-39	225 sh. W. R. Grace & Co., Common	Michael	69,981.32
9-11-39	225 sh. W. R. Grace & Co., Common	Maureen	
9-11-39	225 sh. W. R. Grace & Co., Common	Charles	
11-24-39	2,000 sh. Ingersoll-Rand Co.	Michael	197,134.48
11-24-39	2,000 sh. Ingersoll-Rand Co.	Peter	
12- 4-40	200 sh. Ingersoll-Rand Co.	Peter	3,400.00
12- 4-40	200 sh. Ingersoll-Rand Co.	Michael	3,400.00
12- 4-40	200 sh. Ingersoll-Rand Co.	Maureen	3,400.00
12- 4-40	200 sh. Ingersoll-Rand Co.	Charles	3,400.00
12-24-40	250 sh. Ingersoll-Rand Co.	Peter	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co.	Michael	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co.	Maureen	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co.	Charles	4,250.00
5-13-41	500 sh. Ingersoll-Rand Co.	Peter's wife	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co.	Michael	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co.	Maureen	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co.	Charles	8,500.00
5-14-42	40 sh. Northern Ins. Co.	Peter	
5-14-42	40 sh. Northern Ins. Co.	Michael	6,400.00
5-14-42	40 sh. Northern Ins. Co.	Maureen	
5-14-42	40 sh. Northern Ins. Co.	Charles	
5-14-42	1/4 int. Lakeville Vanhorn Prop.	Peter	
5-14-42	1/4 int. Lakeville Vanhorn Prop.	Michael	2,910.13
5-14-42	1/4 int. Lakeville Vanhorn Prop.	Maureen	
5-14-42	1/4 int. Lakeville Vanhorn Prop.	Charles	
5-14-42	1/4 int. Blakeley Valley Rd. Prop.	Peter	
5-14-42	1/4 int. Blakeley Valley Rd. Prop.	Michael	455.25
5-14-42	1/4 int. Blakeley Valley Rd. Prop.	Maureen	
5-14-42	1/4 int. Blakeley Valley Rd. Prop.	Charles	

17. Subsequent to December 30, 1931, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children:

Date	Book value	Description
4-27-32	$173,434.50	Gift to Joseph P. Grace, 150 shares Thomaston Corp., cap. stock.
12-28-35	180,268.89	Donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Maureen and Charles, 114 sh. W. R. Grace & Co., Pfd. stock, ½ interest in Providence Island Property, 38% interest in a certain $330,523.40 mortgage.
12-31-35	10,728.17	2 shares Lundy's Lane Corp. stock donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Michael.
12-31-36	24,971.30	13,350 shares Grace Bros. & Co., Ltd., gifts to Joseph P. Grace and Janet Grace, as Trustees under instruments dated 8/26/20, 8/26/20, 1/15/25, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively, 3,339 each.
10-20-37	10,728.17	Gifts to each of four children of 2 shares, in all, of Lundy's Lane Corp.
12- 2-37	15,310.00	Gifts of 400 shares of National City Bank to Janet Grace and Joseph P. Grace, as Trustees of 4 trusts created 8/26/20, 8/26/20, 1/5/20, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively (100 shares each).

18. (a) Janet Grace died on December 31, 1937, at the age of 53 years.

(b) At the time of her death, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,550,131.04. Her gross estate (excluding the Janet Grace trust) was valued for Federal estate tax purposes at a total value of $5,550,481.78.

19. Janet Grace continued to act as one of the three trustees of the Janet Grace trust until her death. On January 13, 1938, the decedent, pursuant to a power vested in him under the terms of the trust instrument, appointed Joseph P. Grace, Jr., as successor trustee in the place and stead of Janet Grace, by reason of her death. By reason of the death of another of the original trustees, William R. Grace, on March 31, 1943, Daniel C. Keefe was appointed on May 20, 1943, as successor trustee in the place and stead of William R. Grace, and accepted the appointment on May 21, 1943. From the latter date until the death of the decedent, William G. Holloway, Joseph P. Grace, Jr., and Daniel C. Keefe continued to act as trustees of the Janet Grace trust. The decedent was never a trustee of the Janet Grace trust.

20. (a) During the 6-year period between the creation of the Joseph Grace trust on December 15, 1931, and the death of Janet Grace on December 31, 1937, income from that trust in the amount of $72,908.45 was paid to Janet Grace pursuant to the terms of the Joseph Grace trust.

(b) At the time of Janet Grace's death, the Joseph Grace trust had on hand undistributed income in the amount of $60,719.28.

(c) A distribution of corpus having a book value of $173,-434.50 was made to Janet Grace during her lifetime pursuant to the terms of the Joseph Grace trust.

21. (a) After the death of Janet Grace, her estate filed a Federal estate tax return, in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the latter asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by (1) a reduction in the value, as shown on the return, of the shares of stock in Lundy's Lane Corporation owned by Janet Grace at the date of her death, (2) a reduction in the value, as shown on the return, of the shares of stock in W. R. Grace and Company owned by Janet Grace at the date of her death, and (3) elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. This added $336,783.70 to the taxable estate of Janet Grace. As part of the compromise agreement, the estate of Janet Grace abandoned its counter-contentions, as summarized earlier in this finding.

(b) The compromise agreement referred to in paragraph (a) of this finding involved a reciprocal yielding of positions by both sides. The position yielded by the estate of Janet Grace approximated in monetary terms the position yielded by the Internal Revenue Service with respect to 45 percent of the value of the Janet Grace trust. Thus, the

effect of the compromise agreement was to include the full appraised value of the corpus of the Janet Grace trust at the time of Janet Grace's death, or $612,334, as part of the taxable estate, and to adjust the valuations of other assets of the estate downward by 45 percent of the amount just stated.

(c) In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in paragraph (a) of this finding, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the value of the lesser trust, i.e., the Janet Grace trust, that would be taxable as part of the estate of Janet Grace.

22. The decedent died on July 15, 1950, at the age of 73 years.

23. During the period of approximately 18½ years that intervened between the creation of the Janet Grace trust on December 30, 1931, and the decedent's death on July 15, 1950, a total of $389,465.04 was paid to Joseph Grace pursuant to the terms of the Janet Grace trust.[2] In addition, as indicated in finding 12(c), the decedent had the use and enjoyment of Tullaroan as his family home until the time of his death.

24. (a) After the death of the decedent, a Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent. The trust instruments creating the Joseph Grace trust and the Janet Grace trust were attached to the return as exhibits.

(b) Following an examination of the return referred to in paragraph (a) of this finding, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

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[2] Of this total, the amount of $47,825.18 was distributable to the decedent during the lifetime of Janet Grace.

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under Section 811 (c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate.

(c) The deficiency of $363,500.97 mentioned in paragraph (b) of this finding, plus assessed interest in the amount of $55,720.08, or a total of $419,221.05, was paid by the decedent's estate on July 14, 1954.

25. Under the date of July 13, 1956, there was filed with the appropriate District Director of Internal Revenue, on behalf of the Estate of Joseph P. Grace, Deceased, a claim for "Refund of Taxes Illegally, Erroneously, or Excessively Collected." The claim for refund stated in part as follows:

> MICHAEL P. GRACE, II, one of the executors of the Estate of Joseph P. Grace, Deceased (date of death July 15, 1950), is filing this claim for refund for and on behalf of said Estate. As a rasult of a tax examination of the U.S. Estate Tax return form 706 filed by the Estate of Joseph P. Grace, Deceased, an additional tax of $363,500.97 was assessed in 1954 and this entire amount was paid on July 14, 1954 together with interest of $55.720.05.
>
> The additional tax resulted from the fact that the Revenue Agent's Report in connection with the aforementioned examination increased the Estate's valuation by $1,116,888.62 which allegedly "represents reciprocal trust made by decedent's wife Janet on December 31, 1931 for the benefit of decedent." The R.A.R. stated that the aforestated amount was "includible in the gross estate under Section 811 (C) of the Internal Revenue Code."
>
> This claim for refund is based on the contention that the aforestated trust was not a reciprocal trust and that same was not includible in the Estate of Joseph P. Grace under Section 811 (C) or under any other Section of the Internal Revenue Code.
>
> * * * * *
>
> This claim is for the amount of $419,221.02 plus interest from July 14, 1954. * * *

26. The claim on which this suit is based, as set out in finding 25, had not been disallowed at the time when the petition was filed, and more than 6 months had elapsed since the filing of the claim. No part of the sum so claimed has been credited, refunded, or repaid.

27. The plaintiffs Michael P. Grace II, Joseph Peter Grace, Jr., and Charles MacDonald Grace are the duly qualified and acting executors of the decedent's estate, and as such are qualified to bring this suit.

28. This court has jurisdiction of the case.

29. The Joseph Grace trust and the Janet Grace trust were not created, and properties were not transferred to these trusts, pursuant to any agreement, express or implied, between the decedent and Janet Grace to make reciprocal transfers of properties.

30. The transfer of property by the decedent to the Joseph Grace trust was not in consideration of the transfer of property by Janet Grace to the Janet Grace trust; and the transfer of property by Janet Grace to the Janet Grace trust was not in consideration of the transfer of property by the decedent to the Joseph Grace trust.

Recommendation for Conclusion of Law

It is recommended that the court adopt the following conclusion of law:

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover, and judgment is entered to that effect. The amount of recovery will be determined pursuant to Rule 47 (c).

Respectfully submitted,

Mastin G. White, *Commissioner.*

ORDER

This case comes before the court on the merits, having been submitted on a report of Trial Commissioner Mastin G. White, the exceptions and briefs of the parties and oral argument of counsel. Upon consideration thereof, since it appears to the court that there is some question whether and to what extent certain materials relating to a possible motive on the part of decedent (in the setting up of the two trusts involved here) to avoid estate taxes, are properly before the court at this time, and since the decedent's motivation may have a significant bearing on the disposition of the case, the court exercises its discretion to remand the case to the trial commissioner for a further hearing [at which both parties may present further evidence (including the so-called "Currie Memorandum" if and to the extent properly qualified and introduced, and any other admissible evidence) as to whether the decedent was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid or lessen estate taxes.] The trial commissioner is directed to make a further report taking account of such evidence as may be proffered and admitted into evidence.

It is so ordered.

By the Court, March 25, 1966.

Don N. Laramore, *Judge.*

Chief Judge Cowen dissents.

In the United States Court of Claims

No. 400–59

(Filed February 23, 1967)

ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS v. THE UNITED STATES

SUPPLEMENTAL REPORT OF COMMISSIONER TO THE COURT*

William S. Downard, attorney of record for plaintiffs. *Henry W. Strasburger* and *Frank L. Skillern, Jr.*, of counsel.

Philip R. Miller, with whom was *Assistant Attorney General Mitchell Rogovin*, for defendant. *Lyle M. Turner*, of counsel.

MEMORANDUM OPINION

WHITE, *Commissioner*: The principal problem in this case is whether a trust which Janet Grace created on December 30, 1931, and of which her husband, Joseph P. Grace, was the beneficiary for his lifetime, was includable as part of the taxable estate of Joseph P. Grace upon his death on July 15, 1950.

The first amended petition was filed on August 2, 1963, a trial was held in New York City during the period October 28–November 1, 1963, the parties completed their submissions for the consideration and assistance of the commissioner on July 1, 1964, and the commissioner's initial report, con-

*The memorandum opinion and additional findings of fact are submitted under the order of reference, Rule 57(a), and the court's remand order of March 25, 1966.

taining an opinion, findings of fact, and a recommended conclusion of law, was filed on July 20, 1964.

The evidence received at the trial in 1963 showed (among other things) that the creation of the Janet Grace trust on December 30, 1931 was part of a plan which Joseph P. Grace devised and which also involved the creation by Mr. Grace at about the same time of a trust for the benefit of Janet Grace during her lifetime.

On March 25, 1966, the court issued an order remanding the case to the commissioner "* * * for a further hearing at which both parties may present further evidence * * * as to whether the decedent [Joseph P. Grace] was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid or lessen estate taxes. * * *"

A further trial was held in New York City on July 11 and 12, 1966. Additional testimony (to the extent of 430 transcript pages) was received, and numerous additional documentary exhibits were admitted in evidence. The post-trial submissions by the parties for the consideration and assistance of the commissioner were completed by the parties on February 6, 1967.

It appears from the evidence in the augmented record that Joseph P. Grace never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust on December 15, 1931 and caused his wife to create the Janet Grace trust on December 30, 1931.

It is true that there is a great deal of evidence in the record, as supplemented in July 1966, about a plan which was being promoted during the period 1930–1931 by Alan Ross, of the Grace National Bank's Trust Department, which involved the creation of trusts by a husband and wife for the benefit of each other, and which had, as one of its supposed advantages, the possibility of ultimately minimizing estate taxes. At that time, both the Grace National Bank and W. R. Grace and Company were controlled by the Grace family, of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same building in New York City, and Joseph P. Grace maintained his office in that building.

Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. One of the advantages of his plan, according to Mr. Ross, was that it provided a means whereby a husband and wife could equalize the family income between them and thus effect annual savings in income taxes. Mr. Ross also asserted that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

Details concerning the Ross plan, and regarding Mr. Ross' efforts to interest various persons in the plan, are set out in the additional findings 37–41.

Alan Ross never discussed the creation of trusts with Joseph P. Grace. However, in some manner that is not shown by the evidence, Mr. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Sometime in 1931, Mr. Grace asked Harold J. Roig what the latter thought about the Ross plan. Mr. Roig had formerly been head of the Legal Department of W. R. Grace and Company, was then an official of that company, and occupied an intimate and confidential relationship with Joseph P. Grace. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating that he had not done any legal research on the plan, but that it was his "curbstone" opinion that Mr. Ross'

plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

That Joseph P. Grace, in connection with the creation of the Joseph Grace trust and the Janet Grace trust in December 1931, was not attempting to carry out the Ross plan to minimize estate taxes is indicated by the circumstances that Mr. Grace created the Joseph Grace trust on December 15 and caused Mrs. Grace to create the Janet Grace trust 15 days later, or on December 30, 1931, whereas an essential part of the Ross plan to lessen estate taxes was the lapse of a considerable period of time between the creation of trusts by a husband and wife.

Perhaps specific reference should be made to the circumstances that, as indicated in additional finding 46, Joseph P. Grace was aware of the contention made by the Internal Revenue Service after the death of Janet Grace that the Joseph Grace trust and the Janet Grace trust were reciprocal and one of the trusts was includable as part of the taxable estate of Janet Grace; that Mr. Grace preferred not to litigate the issue; and that he instructed counsel for the estate of Janet Grace to go ahead and make the best settlement with the Internal Revenue Service that was possible. Subsequently, a compromise agreement was entered into between the Internal Revenue Service and the estate of Janet Grace whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. However, Mr. Grace's willingness to compromise a disputed claim cannot properly be regarded as an admission by him that the Internal Revenue Service was correct in its contention that the two trusts were reciprocal. 4 Wigmore, Evidence § 1061(c) (1940).

The reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace trust and to have his wife create the Janet Grace trust, although Mr. Grace did indicate that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly, in December 1931, because it was his view that a gift tax was "coming along any day now."

The additional evidence that has been added to the record does not change my original conclusion that Joseph P. Grace, when he created the Joseph Grace trust on December 15 and caused his wife to create the Janet Grace trust on December 30, 1931, was merely continuing a long-established pattern of conduct.

Additional Findings of Fact

31. In financial matters, Joseph P. Grace was very generous to his wife, Janet Grace. During the period 1911–1929, Mr. Grace transferred (or caused to be transferred) to Mrs. Grace real estate and securities of great value, as well as large amounts of cash (see findings 4, 6, and 7). Janet Grace had practically nothing in the way of wealth when she married Joseph P. Grace, and as a result of his generosity, she ended up having approximately as much wealth as he did. Indeed, Mr. Grace's transfers of income-producing properties to Mrs. Grace were so extensive that ultimately he became worried over whether the income-producing properties still in his possession would be sufficient to defray the annual expenses for which he was responsible, amounting to at least $200,000 per year. Because of this worry, Mr. Grace had Mrs. Grace retransfer to him some securities that he had previously given to her. For example, on March 31, 1929, Mr. Grace had Mrs. Grace retransfer to him 200 shares of stock in the Lundy's Lane Corporation, having a book value of $613,444.32 (see finding 9). Notwithstanding such retransfers, Mrs. Grace still owned extremely valuable properties as the result of gifts originally received from Mr. Grace.

32. In his relations with his children, Joseph P. Grace was both generous and "trust minded" (see findings 8 and 16). He apparently was motivated by a desire to equalize benefits among the various children.

33. In establishing trusts for the benefit of his children, Joseph P. Grace dealt with J. Morden Murphy, head of the Customers Securities Department of W. R. Grace and Company. Mr. Grace would customarily tell Mr. Murphy for whose benefit he desired to create a trust and the assets that he desired to transfer to the trust. Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, would prepare the necessary papers to effectuate Mr. Grace's wishes, and Mr. Grace would sign them.

34. (a) At the time involved in the present litigation, both W. R. Grace and Company and the Grace National Bank were controlled by the Grace family, of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same building in New York City. Joseph P. Grace maintained his office in the same building.

(b) The Legal Department of W. R. Grace and Company provided legal services not only for that company but also for the Grace National Bank.

(c) The "securities cage" of the Grace National Bank handled the physical delivery and receipt of securities for the bank and for W. R. Grace and Company.

35. J. Morden Murphy was head of the Customers Securities Department of W. R. Grace and Company throughout the period 1930–1931. It was the principal function of that department to manage the securities and real estate of members of the Grace family, most of whom lived in the United States but some of whom lived in England. A great many trusts had been created for various members of the Grace family, and such trusts, together with the securities and real estate in them, were managed by the Customers Securities Department.

36. Alan Ross was employed in the Trust Department of the Grace National Bank throughout the period 1930–1931, and he became head of that department sometime during such period. The Trust Department of the bank did not have any connection with the trusts established for the benefit of members of the Grace family, or with any other aspects of the Grace family's affairs.

37. (a) Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. If only one spouse in a husband-and-wife relation-

ship was wealthy, it was part of Mr. Ross' plan that the wealthy spouse could transfer property directly to the other spouse, and the husband and wife could then create trusts for the benefit of each other in the manner previously mentioned.

(b) Mr. Ross pointed out to prospective customers that his plan could be utilized for the purpose of equalizing the family income between a husband and wife, and thus effecting annual savings in income taxes.

(c) Mr. Ross also expressed the view to prospective customers that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

38. Alan Ross' plan for husbands and wives in wealthy families to create trusts for the benefit of each other as a means of equalizing income and effecting annual savings in income taxes, and also of ultimately effecting savings in estate taxes if proper precautions were taken in timing the creation of the trusts, was known to, and discussed among, personnel of the Customers Securities Department of W. R. Grace and Company (J. Morden Murphy and his assistant, Allen S. Rupley) and of the Legal Department of W. R. Grace and Company (Howard N. Deyo, Andrew B. Shea, and a Mr. Cogswell). Howard N. Deyo, head of the Legal Department, did not regard the plan as a sound device for minimizing taxes.

39. (a) Alan Ross suggested to Harold J. Roig that the latter and his wife execute trusts for the benefit of each other. Mr. Roig was an attorney and formerly had been head of the Legal Department of W. R. Grace and Company. In 1930–1931, Mr. Roig occupied an executive position in W. R. Grace and Company, and he also occupied an intimate and confidential relationship with Joseph P. Grace.

(b) Mr. Roig was not interested in Mr. Ross' plan.

40. Alan Ross endeavored to interest William Russell Grace, a brother of Joseph P. Grace, in Mr. Ross' plan for the creation of trusts by a husband and wife for the benefit of

each other. William Russell Grace was not interested in the Ross plan.

41. (a) Sometime during the latter part of 1930, Alan Ross approached D. Stewart Iglehart, president of W. R. Grace and Company, and suggested that it might be advantageous if Mr. Iglehart and his wife were to create trusts for the benefit of each other.

(b) Mr. Ross suggested to Mr. Iglehart that the latter could possibly save some income taxes annually by splitting up his income-producing properties between himself and his wife, and then the two of them creating trusts for the benefit of each other. Mr. Ross also suggested to Mr. Iglehart that such a plan would result in savings on estate taxes if Mr. Iglehart first created a trust for the benefit of his wife and then Mrs. Iglehart waited for a reasonable length of time (Mr. Ross suggested at least a year) before creating a trust for the benefit of Mr. Iglehart, so that it would not appear that the two trusts were created as part of a single plan to avoid the payment of estate taxes.

(c) Mr. Ross had a number of conferences with Mr. Iglehart, extending over a period of several months, in connection with Mr. Ross' suggestion that Mr. Iglehart and his wife create trusts for the benefit of each other. Mr. Iglehart was interested in the plan, but he had his own ideas concerning certain provisions which the trust instruments should contain. For example, Mr. Iglehart insisted that each trust instrument should contain a provision whereby the life beneficiary would have the power, at will, to withdraw all or any part of the principal of the trust at any time.

(d) As a result of the discussions mentioned in this finding, Mr. Iglehart asked Mr. Ross to draft proposed trust instruments in final form, so that Mr. Iglehart could examine them. A list of the assets that might be included in the two trusts was furnished to Mr. Ross by Mr. Iglehart's secretary, pursuant to instructions from Mr. Iglehart.

(e) In accordance with the authorization from Mr. Iglehart, Mr. Ross prepared final drafts of proposed trust instruments whereby Mr. Iglehart and his wife could create trusts for the benefit of each other. Mr. Ross then submitted the proposed trust instruments to Mr. Iglehart for consideration.

(f) A few days later, Mr. Ross found on his desk the two

trust instruments that he had submitted to Mr. Iglehart. The document drafted by Mr. Ross for the creation of a trust by Mr. Iglehart for the benefit of his wife had been signed by Mr. Iglehart on February 9, 1931; and the document drafted by Mr. Ross for the creation of a trust by Mrs. Iglehart for the benefit of her husband had been signed on the same date, i.e., February 9, 1931. The execution of the two trust instruments on the same date was not in accordance with the recommendation as to timing that Mr. Ross had previously made to Mr. Iglehart if savings in estate taxes were to be an objective.

42. D. Stewart Iglehart and Joseph P. Grace had been college classmates, and they were close personal friends. Mr. Grace had brought Mr. Iglehart into the Grace organization. In 1930–1931, Mr. Iglehart was president of W. R. Grace and Company, and Joseph P. Grace was chairman of the board of that company.

43. Alan Ross never discussed the creation of trusts, or business matters of any kind, with Joseph P. Grace. Mr. Ross never met Janet Grace.

44. In some manner that is not shown by the evidence, Joseph P. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Sometime in 1931, Mr. Grace asked Harold J. Roig what he thought of Mr. Ross' idea respecting such trusts. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating, in effect, that he had not done any legal research on the question, but that it was his "curbstone" opinion that Mr. Ross' plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

45. (a) With respect to the creation of the Joseph Grace trust of December 15, 1931 and the Janet Grace trust of December 30, 1931 (see findings 10, 11, and 12), there had been no prior consultation concerning any such plan by Mr. Grace with J. Morden Murphy when Mr. Grace, in early December of 1931, informed Mr. Murphy that he (Mr. Grace) wanted to have some trusts created by himself and

Mrs. Grace, and that Mr. Murphy should obtain and furnish to Mr. Grace the respective balance sheets of Mr. and Mrs. Grace, showing the assets held at the time by each of them, so that Mr. Grace might select the assets that were to be transferred to the respective trusts.

(b) Mr. Murphy obtained and furnished the two balance sheets to Mr. Grace. Mr. Grace examined the balance sheets, went down each list of assets, and selected the properties that were to be put into the two trusts.

(c) Mr. Grace indicated to Mr. Murphy that he wanted to put into the Joseph Grace trust all the properties of value which he still had and which were of such a nature that they would be suitable to be put in a trust for the lifetime of Mrs. Grace and then go to their children after Mrs. Grace's death.

(d) In connection with the creation of the Janet Grace trust, Mr. Grace selected Tullaroan, the family estate, to be put into that trust, and he also selected 40 shares of stock in the Lundy's Lane Corporation, indicating that the trust should have sufficient income-producing property to defray the taxes on Tullaroan.

(e) Mr. Grace did not make any statement to Mr. Murphy—or to anyone else, according to the evidence in the record—concerning the reason or reasons for the creation of the two trusts, although he indicated that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly in December 1931 because it was his view that a gift tax was "coming along any day now."

(f) It had previously been Mr. Grace's custom, in connection with the creation of trusts for the benefit of his children, to have Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, draft the necessary instruments to accomplish Mr. Grace's instructions. In connection with the creation of the Joseph Grace and the Janet Grace trusts of December 1931, however, Mr. Grace had in his possession, on the occasion of his first conference with Mr. Murphy, a draft of a trust instrument (or possibly drafts of two such instruments), which Mr. Grace gave to Mr. Murphy. Mr. Grace indicated to Mr. Murphy that the draft was to be used as a model in preparing the final versions of the instruments creating the Joseph Grace trust and the Janet Grace trust of December 1931. The draft was similar

in several respects to the instruments creating the Iglehart trusts (see finding 41).

(g) In connection with the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, Mr. Grace did not indicate any desire to equalize the values of the properties that were to be put in the respective trusts. As a matter of fact, there was considerable uncertainty at the time concerning the true market values of the various properties that were transferred to the respective trusts. This was especially true with respect to Tullaroan, the family estate that was placed in the Janet Grace trust, and the pieces of real estate that were placed in the Joseph Grace trust. It was finally decided that, for the purpose of setting up books of account for the two trusts, approximate values would be assigned to Tullaroan and to the pieces of real estate that were put in the Joseph Grace trust, as it seemed unnecessary to make the considerable effort that would have been required to obtain accurate appraisals.

(h) After Joseph P. Grace had selected the various properties that were to be transferred to the Joseph Grace trust and the Janet Grace trust of December 1931, the final drafts of the documents creating those trusts were prepared in the Legal Department of W. R. Grace and Company. It is inferred that this assignment was relayed to the Legal Department by J. Morden Murphy. The final drafts were modeled on the earlier draft which Mr. Grace had given to Mr. Murphy on the occasion of their first conference concerning the creation of the trusts, although certain changes were made by the Legal Department.

46. (a) During the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace concerning the includability of certain property items in the estate tax return of the estate of Janet Grace (see finding 21), Joseph P. Grace attended a conference with Oscar M. Bate and Robert L. Loeb. Messrs. Bate and Loeb were members of the law firm of McFarlane & Munroe, which was representing the estate of Janet Grace and which also acted as counsel to Joseph P. Grace from time to time with respect to legal matters which Mr. Grace believed to be beyond the competency of the Legal Department of W. R. Grace and Company. At the conference, Mr. Bate, who was senior to

Mr. Loeb in their law firm, informed Mr. Grace that the Internal Revenue Service was taking the position that the trusts created by Mr. Grace and his wife in December 1931 were reciprocal trusts and that, under fairly recent court decisions, one of the trusts was includable in the estate tax return of Janet Grace. Mr. Bate advised Mr. Grace that if the trusts were set up in consideration of each other, the law firm felt that one of the trusts was includable in the estate tax return of Janet Grace, but the firm did not know which one. Mr. Bate further stated that he thought the Internal Revenue Service could probably be persuaded to accept the view that the trust created by Mrs. Grace was the one taxable against her estate, and that this would be advantageous because, at the time of Mrs. Grace's death, the assets in the Janet Grace trust had a considerably smaller value than the assets in the trust created by Mr. Grace.

(b) Mr. Grace, in effect, told Mr. Bate to go ahead and make the best settlement with the Internal Revenue Service that he could.

(c) Mr. Grace, at the conference, did not deny the reported contention by the Internal Revenue Service that the Joseph Grace trust and the Janet Grace trust of December 1931 were created in consideration of each other.

(d) As the result of the negotiations between the Internal Revenue Service and the estate of Janet Grace, a compromise agreement was entered into whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned the counter-contentions which the estate had asserted during the course of the negotiations, to the effect that certain shares of stock had been over-valued in the estate tax return and that certain household effects previously included in the estate tax return should be eliminated from it.

47. Following the payment of the deficiency and interest in the total amount of $419,221.05 by the estate of Joseph P. Grace on July 14, 1954 (see finding 24), Michael P. Grace, II, one of the sons of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, proposed to Joseph Peter Grace Jr., and Charles MacDonald Grace, his two brothers and fellow executors, that a claim for refund be

filed by the estate of Joseph P. Grace with the Internal Revenue Service.

48. (a) On June 27, 1956, Joseph Peter Grace, Jr., a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, conferred with his attorney, Judge Burns, of the law firm of Burns, Currie, Maloney & Rice, with Francis Currie, a partner of Judge Burns, with Allen S. Rupley, who was then an official of W. R. Grace and Company, with Mr. Cogswell, of the Legal Department of W. R. Grace and Company, with Mr. Ray, who was then the senior trust officer of the Grace National Bank (the bank being part of the committee for Janet Maureen Grace), and with Robert L. Loeb, counsel for the estate of Janet Grace. The purpose of the conference was to determine whether Joseph Peter Grace, Jr., should join with Michael P. Grace, II, in filing a claim for refund on behalf of the estate of Joseph P. Grace.

(b) Francis Currie had previously conducted an investigation among personnel of W. R. Grace and Company and of the Grace National Bank in an effort to develop as much information as possible concerning the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, and Mr. Currie disclosed to the conferees on June 27, 1956 the results of his investigation.

(c) Robert L. Loeb informed the conferees on June 27, 1956 concerning the conference that he had attended with Joseph P. Grace during the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace (see finding 46). Mr. Loeb said to the conferees on June 27, 1956 that he thought Joseph P. Grace, at the earlier conference, recognized that the two trusts were factually reciprocal, that Mr. Grace did not wish to litigate the issue, and that Mr. Grace wanted to make a settlement.

(d) On the basis of the discussion at the conference on June 27, 1956, Joseph Peter Grace, Jr., instructed his attorney not to join in a claim for refund.

49. (a) On July 9, 1956, Charles MacDonald Grace, a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, attended a conference with his attorney, Judge Burns, with Francis Currie, and with Mr. McDevitt. The other conferees informed Charles MacDonald Grace of the decision previously made by Joseph Peter Grace, Jr.,

not to join in a claim for refund (see finding 48), and they advised Charles MacDonald Grace that he should also decline to join in such a claim.

(b) In accordance with the advice received by him, Charles MacDonald Grace said at the conference on July 9, 1956 that he would not join in a claim for refund.

50. On August 2, 1956, Francis Currie wrote a letter to Morris W. Primoff, attorney for Michael P. Grace, II, and stated in part as follows:

> I am authorized to say that Messrs. Peter and Charles Grace are completely satisfied that the available evidence will not sustain the burden of proof to support the claims for refund filed by Mr. Michael Grace. On the contrary, all available evidence indicates that the trusts in question were specifically intended to be reciprocal, in order to avoid gift taxes which became effective on January 1, 1932, and to avoid estate taxes through a method generally regarded as available prior to the decision in the *Lehman* case. In the light of this evidence of which they are aware, Messrs. Peter and Charles Grace cannot join in the claims for refund filed by Mr. Michael Grace.
>
> Messrs. Peter and Charles Grace have reached this conclusion reluctantly, in view of their personal interests in any refund which might be recovered. The share of Mr. Charles Grace in the amount of federal estate tax and interest which might be recovered if the claim for refund were allowed would be almost $40,000.; the share of Mr. Peter Grace would be over $235,000., considerably larger than the share of Mr. Michael Grace.
>
> I am also authorized to say that Grace National Bank of New York, as a member of the Committee for the Property of Janet Maureen Grace, concurs in the decision of Messrs. Peter and Charles Grace not to join in the claim for refund.

51. (a) The original petition in the present action was filed on September 24, 1959 by Michael P. Grace, II, as an executor of the estate of Joseph P. Grace, deceased.

(b) After the filing of the original petition, the attorney for Michael P. Grace, II, represented to Joseph Peter Grace, Jr., and Charles MacDonald Grace that the claim asserted in the petition might be denied by the court on the ground of defective parties plaintiff. At the request of the attorney for Michael P. Grace, II, and because Joseph Peter Grace, Jr., and Charles MacDonald Grace did not wish to forfeit any

money that they might be entitled to receive, Joseph Peter Grace, Jr., and Charles MacDonald Grace decided to join in the prosecution of the case before the Court of Claims.

(c) On August 2, 1963, the first amended petition was filed in the present action by the estate of Joseph P. Grace, deceased, and by Michael P. Grace, II, Joseph Peter Grace, Jr., and Charles MacDonald Grace, executors.

52. The evidence in the record does not indicate that Joseph P. Grace was motivated by the desire to avoid or lessen estate taxes in the setting up of the Joseph Grace trust and the Janet Grace trust in December 1931.

53. The Joseph Grace trust and the Janet Grace trust were created by, or at the instigation of, Joseph P. Grace as parts of what was essentially a single transaction.

ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS ET AL. PLAINTIFFS

v.

U.S., DEFENDANT

U.S. Court of Claims, No. 400–59, April 19, 1968

Before COWEN, Chief Judge, LARAMORE, DURFEE, DAVIS, SKELTON, and NICHOLS, Judges.

OPINION

PER CURIAM:

This case was referred to Trial Commissioner Mastin G. White with directions to make findings of fact and recommendation for conclusions of law. Following a trial on the merits, the commissioner filed an opinion and report, and the case was submitted to the court on the briefs of the parties. After hearing oral argument of counsel, we remanded the case to the commissioner for determination "whether the decedent [Joseph P. Grace] was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid and lessen estate taxes." A further trial was held and thereafter the commissioner filed his supplemental report and a memorandum opinion.

After hearing additional oral argument and considering the briefs and exceptions of the parties, we have determined that the findings of fact made by the commissioner are amply supported by the record and

that where such findings consist of inferences based on circumstantial evidence, the inferences may reasonably be drawn from the record. The court is also in agreement with the opinions of the trial commissioner, as modified and combined into a single opinion, and hereby adopts the same, together with his findings of fact, as the basis for its judgment in this case.[1] Therefore, plaintiffs are entitled to recover and judgment is entered to that effect with the amount of recovery to be determined pursuant to Rule 47(c).

Commissioner White's opinions, as modified and unified by the court, are as follows:

The primary question to be decided in this case is whether the Internal Revenue Service acted correctly in adding to the gross estate of Joseph P. Grace, who died on July 15, 1950, the sum of $1,116,-888.62, representing the value of a trust that had been created on December 30, 1931.

The Internal Revenue Service purported to act under the authority of Section 811(c) of the Internal Revenue Code of 1939, as amended.[2] That section, at the time of the decedent's death, provided (among other things) that the value of the gross estate of a decedent should be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, "To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * the possession or enjoyment of, or the right to the income from, the property * * *."

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[1] The dissenting opinion of Davis, Judge, in which Nichols, Judge, concurs follows the opinion of the Trial Commissioner which has been adopted by the court.

[2] When the decedent died on July 15, 1950, the original language of Section 811(c), as found in 53 Stat. at pp. 120–121, had been amended by Section 7(a) of the Act of October 25, 1949 (63 Stat. 891, 894).

It is clear that under the provisions of the trust of December 30, 1931, the decedent for his lifetime had the right to the income from the income-producing portion of the trust property, and that he was entitled to the possession and enjoyment of the remainder of the trust property. On the other hand, the decedent, at least in form, was not the settlor of the trust, he had not directly "made a transfer" of any property or interest in property to the trust, and, strictly speaking he had not "retained" any beneficial interest in the trust property but, rather, had obtained such interest by virtue of the instrument creating the trust The person who executed the instrument creating the trust of December 30, 1931, and who directly transferred to that trust all the property covered by it, was the decedent's wife, Janet Grace. (For the sake of convenience, the trust of December 30, 1931, will usually be referred to hereafter in the opinion as "the Janet Grace trust.")

The defendant contends that the decedent, by himself creating on December 15, 1931, a reciprocal trust which conferred on Janet Grace benefits similar to those which were conferred on the decedent by the Janet Grace trust, furnished consideration for the creation of the Janet Grace trust; and, therefore, that for estate-tax purposes the decedent and Janet Grace should be switched or crossed as settlors and the decedent should be regarded as having been in substance the settlor of the Janet Grace trust. This contention is based upon a judicially developed rule that was first announced in the case of *Lehman* v. *Comm'r*, 109 F. 2d 99 (2d Cir. 1940), cert. denied 310 U.S. 637.

The facts in the *Lehman* case were stipulated by the parties. According to the stipulation, two brothers, Harold M. and Allan S. Lehman, owned equal shares

in certain stocks and bonds. Harold agreed to transfer his share in trust for Allan and the latter's issue, in consideration of Allan transferring his share in trust for Harold and Harold's issue, and trusts were created in accordance with the agreement. The income from the trust property transferred by Harold was to be paid to Allan for his life, with the remainder to Allan's issue, and Allan had the right to withdraw not to exceed $150,000 of the principal. Similarly, the income from the trust property transferred by Allan was to be paid to Harold for his life, with the remainder to Harold's issue, and Harold had the right to withdraw up to $150,000 of the principal. Harold later died, and the court was called upon to decide whether trust property transferred by Allan was taxable as part of Harold's estate. This question was answered in the affirmative. The Court said (109 F. 2d at pp. 100–101) that Harold, by transferring his share of the stocks and bonds in trust for the benefit of Allan and the latter's issue, had "paid for and brought about" the transfer by Allan of his share of the stocks and bonds in trust for the benefit of Harold and Harold's issue; and, therefore, that Allan's transfer was in substance a transfer by Harold, so as to make the property so transferred part of Harold's taxable estate.

There are two divergent views of the precise proposition that the *Lehman* case stands for, each espoused in several cases. Since, in this case the same result is reached under either view, we have not felt it necessary to choose between the two lines of cases. Each shall be considered in turn.

According to one line of cases, the crucial factor in the *Lehman* case was that, under the agreed facts, Harold Lehman had furnished consideration for—i.e., he had "paid for and brought about" the transfer of

property by Allan Lehman in trust for the benefit of Harold Lehman and the latter's issue. *In re Lueders' Estate,* 164 F. 2d 128, 133–4 (3d Cir. 1947); *Newberry's Estate* v. *Comm'r,* 201 F. 2d 874, 877 (3d Cir. 1953); *McLain* v. *Jarecki,* 232 F. 2d 211, 213 (7th Cir. 1956); *Tobin* v. *Comm'r,* 183 F. 2d 919 (5th Cir. 1950), cert. denied, 340 U.S. 904. See also *Estate of Lindsay,* 2 T.C. 174 (1943); *Guenzel's Estate* v. *Comm'r,* 258 F. 2d 248 (8th Cir. 1958). In the present case, it becomes necessary, under the rule followed in the above-cited cases, to determine whether the decedent by creating the trust of December 15, 1931, was furnishing consideration for—i.e., whether he was paying for—the subsequent creation of the Janet Grace trust on December 30, 1931. This is a question of fact, which involves an inquiry into the element of motivation. The facts show that when decedent created the Joseph Grace trust, he was not paying for the transfer of the property covered by the Janet Grace trust and that when Janet Grace made such transfers to the Janet Grace trust, she was not induced or caused to do so by reason of the previous establishment of the Joseph Grace trust by the decedent.

Unfortunately, it is necessary to rely largely on circumstantial evidence in making the factual determination that is crucial in the disposition of this case, as both the decedent and Janet Grace were dead at the time of the trial. Consequently, it will be necessary to outline in considerable detail the known facts which appear to be pertinent in drawing inferences with respect to the motivation which led the decedent and Janet Grace to create the trusts of December 15 and 30, 1931.

The decedent and Janet Grace were married in August 1908. Five children, three sons and two daughters, were born to them. One of the daughters died in

1935, but the other four children were living at the time of the trial.

The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not thereafter inherit any substantial wealth. However, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers which the decedent made to her, either directly or indirectly. For example, when the decedent on April 5, 1911, paid the purchase price for and acquired a 167-acre farm on Long Island for the purpose of developing it into a homestead for the family, he caused the legal title to be vested in Janet Grace. Thereafter, the decedent proceeded at great expense to convert the acreage into a country estate for use as the family home. The property was called Tullaroan, and it included among the numerous improvements a 65-room colonial-style residence for the family. Tullaroan became the home of the decedent and Janet Grace in about 1911, and it continued to be their home for the remainder of their lives.

There is in the record evidence concerning 24 transfers of property and financial interests by the decedent to Janet Grace during the period between April 19, 1917, and May 10, 1929. One of these transfers involved 3,000 shares of stock in the Ingersoll-Rand Company having a book value of $300,000, and there were 9 additional instances where property having a book value of $100,000 or more was transferred by the decedent to Janet Grace.

The record also contains evidence regarding the creation by the decedent, during the period between August 26, 1920, and June 5, 1930, of 26 trusts for

the benefit of his children. While in most instances the properties transferred by the decedent to these various trusts had relatively modest book values, the decedent provided 5 of the trusts with properties having book values in excess of $100,000 for each trust.

In addition, the record contains evidence concerning five instances during the period between August 26, 1920, and March 31, 1929, when Janet Grace made transfers of assets to or for the benefit of the decedent or their children. These incidents involved transfers of properties having book values ranging all the way from $3,860.15 to $613,344.32. It is interesting to note that the largest of these transfers, which was shown by the record to have been a gift from Janet Grace to the decedent, in effect involved a retransfer by Janet Grace to the decedent of property which the decedent had transferred to her in the first instance. What Janet Grace transferred to the decedent in that instance was stock in a personal holding company which had been set up on behalf of Janet Grace to hold valuable corporate shares which the decedent had previously transferred to Janet Grace.

The decedent exercised supervision and control over, and he made the decisions that were involved in the management of the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or dis-

position of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument. Therefore, although there is no direct evidence in the record relative to the circumstances that were involved in the transfers of assets by Janet Grace previously mentioned, it is reasonable to infer that such transfers were made by Janet Grace in accordance with plans devised by the decedent.

In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Company to assist him by handling the details that were involved in carrying out his decisions.

The events that led directly to the creation by the decedent of the trust dated December 15, 1931, and to the creation of the Janet Grace trust on December 30, 1931, began in early December of 1931, when the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company, concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts for the benefit of the family should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with transfers of assets to such trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships. The decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the owner-

ship of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had in his possession drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

Following the conference mentioned in the preceding paragraph, and in accordance with the plan devised by the decedent, he executed on December 15, 1931, a trust instrument which created a trust that will be referred to hereafter in the opinion as "the Joseph Grace trust." William R. Grace, William G. Holloway, and the decedent himself were named in the instrument as trustees of the Joseph Grace trust. The trustees were directed to pay the income from the trust to Janet Grace during her lifetime, and also to pay to her any amounts of the principal which a majority of the trustees might deem advisable. Janet Grace was given the power to designate, by will or deed, the manner in which the trust estate remaining at the time of her death should be distributed to or for the benefit of the decedent and their children.

In connection with the execution of the trust instrument on December 15, 1931, the decedent transferred to the Joseph Grace trust blocks of the capital stock of three corporations, several parcels of real estate, and a one-fourth undivided interest in a certain joint venture which, at the time, owned a tract of land, a number of real estate mortgages, other receivables, cash, and 10,620 shares of common stock in the Ingersoll-Rand Company.

Fifteen days after the creation of the Joseph Grace trust by the decedent, Janet Grace on December 30,

1931, acting in accordance with the plan of the decedent previously mentioned, executed the trust instrument which created the Janet Grace trust. William R. Grace, William G. Holloway, and Janet Grace were named as the trustees of the Janet Grace trust. Under the provisions of this trust, the trustees were to pay the income from the trust property to the decedent during his lifetime, together with any amounts of the principal which a majority of the trustees might deem advisable. Also, the trust instrument directed that, during the life of the decedent, he should be entitled to the use and occupancy of the real property that was included in the trust.

In connection with the execution of the trust instrument referred to in the preceding paragraph, Janet Grace on December 30, 1931, transferred to the Janet Grace trust the family homestead, Tullafoan, and 40 shares of stock in a corporation known as Lundy's Lane Corporation. That corporation was a personal holding company which had been incorporated on behalf of Janet Grace on November 9, 1923. At that time, she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock, and 3,040 shares of W. R. Grace and Company preferred stock, all of which had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of stock in Lundy's Lane Corporation originally owned by Janet Grace, she made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totalling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. After the creation of the Janet Grace trust on December 30, 1931, Janet Grace continued to own 367 shares of stock in Lundy's Lane Corporation,

the decedent owned 100 shares, the Janet Grace trust owned 40 shares, and the five trusts previously created by the decedent for the benefit of his children owned 20 shares each.

The pattern of creating trusts for the benefit of members of the family, and of transferring assets directly to members of the family, continued during the years that followed the creation of the Joseph Grace trust and the Janet Grace trust in December of 1931. Both the decedent and Janet Grace were involved in such actions.

Janet Grace died on December 31, 1937, at the age of 53 years. The Joseph Grace trust terminated with the death of Janet Grace. The estate of Janet Grace filed a Federal estate tax return in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the IRS asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by reductions in the values, as shown on the return, of certain blocks of corporate stock owned by Janet Grace at the date of her death, and by elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the

corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned its counter-contentions.

In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in the preceding paragraph, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the value of the lesser trust (i.e., the Janet Grace trust) that would be taxable as part of the estate of Janet Grace.

The decedent died on July 15, 1950, at the age of 73 years. A Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the decedent's gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent.

Following an examination of the return referred to in the preceding paragraph, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under Section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue

Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate. This deficiency, plus assessed interest in the amount of $55,720.08, was paid by the decedent's estate on July 14, 1954.

A claim for refund was subsequently filed with the Internal Revenue Service on behalf of the decedent's estate. Administrative relief was not obtained, and the present action followed.

A very significant fact in connection with the creation of the Joseph Grace trust and the Janet Grace trust was that, as inferred from the evidence in the whole record, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences. These transfers were part of a well-established pattern of conduct, managed by the decedent, which began as early as 1911, which continued for many years, and which involved numerous transfers of valuable property and financial interests among the members of the family.

It is certainly obvious that the decedent, when he created the Joseph Grace trust on December 15, 1931, was not motivated by any intention to give consideration for, or pay for, the transfer of Tullaroan by Janet Grace to the Janet Grace trust on December 30, 1931, in order that he might obtain the right to the use and enjoyment of the family homestead. As previously indicated, Tullaroan had been the family homestead since about 1911. The decedent had paid the original purchase price for Tullaroan, although the title had been taken in the name of Janet Grace, and the decedent had subsequently provided the funds that were

required for the construction of the buildings and other improvements in developing Tullaroan into a country estate (except that an uncle of the decedent bore the cost of making certain additions to the main residence in about 1920). At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan during their lives; and, in fact, they both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust. Consequently, there is no basis in the record for a finding that the decedent created the Joseph Grace trust and transferred property to it in order to induce Janet Grace to transfer Tullaroan to the Janet Grace trust so that the decedent might obtain the right to the use and enjoyment of the family homestead.

It would also be unrealistic to find that the decedent, in creating the Joseph Grace trust on December 15, 1931, intended to furnish consideration for, or pay for, the transfer by Janet Grace of the 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust. That corporation was a personal holding company that had been established on behalf of Janet Grace to hold valuable shares of corporate stock which the decedent himself had previously given to Janet Grace. Actually, as stated heretofore, the inference to be drawn from the whole record is that the decedent, when he created the Joseph Grace trust and transferred property to it, was not motivated by a desire to obtain any sort of property, or interest in property, from Janet Grace. Rather, he was merely continuing a long-established pattern of conduct, and

the immediate motivation was a desire to effect transfers of assets among members of the family before an expected new gift tax became effective.

Conversely, there is no basis in the record for a finding that Janet Grace, in transferring Tullaroan and 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust. Indeed, there is no evidence in the record that Janet Grace even knew about the creation of the Joseph Grace trust by the decedent. Cf. *Hanauer's Estate* v. *Comm'r*, 149 F. 2d 857, 859 (2d Cir., 1945), cert. denied 326 U.S. 770. On the basis of the whole record, it is reasonable to infer that Janet Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so; and that if any explanation at all was given to Janet Grace by the decedent, it was merely to the effect that a probable saving in gift tax could be effected if such actions were taken by Janet Grace before the end of 1931.

However, there remains for consideration a separate line of cases which apply different legal standards in determining the existence of consideration within the meaning of the *Lehman* case. These cases vary somewhat in the statement of the rule, but basically they look at the objective evidence to determine whether trusts created by husband and wife similar to those involved in this case are reciprocal and taxable. In some of these cases, consideration is inferred from the fact that the properties included in the two trusts are of approximately the same amount, that the trusts are created at or about the same time, and that each grantor gives the other a life estate in income, so that the trust would normally be included in his estate

if the grantor had reserved that power to himself. *Cole's Estate* v. *Comm'r,* 140 F. 2d 636 (8th Cir. 1944). Other cases in this group hold that the same inference will be made unless rebutted by clear evidence. *Hanauer's Estate* v. *Comm'r,* 149 F. 2d 857 (2d Cir. 1945), cert denied, 326 U.S. 770; *Orvis* v. *Higgins,* 180 F. 2d 537 (2d Cir. 1950), cert denied, 340 U.S. 810. In still others, the presence or absence of a motive to avoid the payment of estate taxes has been an important factor in deciding the application of the "reciprocal trust" doctrine. *Estate of Louis D. Ruxton,* 20 T.C. 487 (1953). The additional evidence heard at the second trial in this case and the facts found therefrom do not change the result when the rule announced in the above-cited cases is applied here.

It appears from the evidence in the augmented record that Joseph P. Grace never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust on December 15, 1931 and caused his wife to create the Janet Grace trust on December 30, 1931. The evidence also establishes the existence of other logical and even compelling motives for these transactions.

It is true that there is a great deal of evidence in the record, as supplemented in July 1966, about a plan which was being promoted during the period 1930–1931 by Alan Ross, of the Grace National Bank's Trust Department, which involved the creation of trusts by a husband and wife for the benefit of each other, and which had, as one of its supposed advantages, the possibility of ultimately minimizing estate taxes. At that time, both the Grace National Bank and W. R. Grace and Company were controlled by the Grace family, of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same build-

ing in New York City, and Joseph P. Grace maintained his office in that building.

Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. One of the advantages of his plan, according to Mr. Ross, was that it provided a means whereby a husband and wife could equalize the family income between them and thus effect annual savings in income taxes. Mr. Ross also asserted that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

Details concerning the Ross plan, and regarding Mr. Ross' efforts to interest various persons in the plan, are set out in the additional findings 37–41.

Alan Ross never discussed the creation of trusts with Joseph P. Grace. However, in some manner that is not shown by the evidence, Mr. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Some-

time in 1931, Mr. Grace asked Harold J. Roig what the latter thought about the Ross plan. Mr. Roig had formerly been head of the Legal Department of W. R. Grace and Company, was then an official of that company, and occupied an intimate and confidential relationship with Joseph P. Grace. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating that he had not done any legal research on the plan, but that it was his "curbstone" opinion that Mr. Ross' plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

That Joseph P. Grace, in connection with the creation of the Joseph Grace trust and the Janet Grace trust in December 1931, was not attempting to carry out the Ross plan to minimize estate taxes is indicated by the circumstances that Mr. Grace created the Joseph Grace trust on December 15 and caused Mrs. Grace to create the Janet Grace trust 15 days later, or on December 30, 1931, whereas an essential part of the Ross plan to lessen estate taxes was the lapse of a considerable period of time between the creation of trusts by a husband and wife.

Perhaps specific reference should be made to the circumstances that, as indicated in additional finding 46, Joseph P. Grace was aware of the contention made by the Internal Revenue Service after the death of Janet Grace that the Joseph Grace trust and the Janet Grace trust were reciprocal and one of the trusts was includable as part of the taxable estate of Janet Grace; that Mr. Grace preferred not to litigate the issue; and that he instructed counsel for the estate of Janet Grace to go ahead and make the best settlement with the Internal Revenue Service that was possible. Subse-

quently, a compromise agreement was entered into between the Internal Revenue Service and the estate of Janet Grace, whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. However, Mr. Grace's willingness to compromise a disputed claim cannot properly be regarded as an admission by him that the Internal Revenue Service was correct in its contention that the two trusts were reciprocal. 4 Wigmore, Evidence § 1061(c) (1940).

[1] The reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace trust and to have his wife create the Janet Grace trust, although Mr. Grace did indicate that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly, in December 1931, because it was his view that a gift tax was "coming along any day now."

Therefore, if we take the view of those cases which impose the burden on the taxpayer to rebut any inference arising under the circumstances of this case that the Janet Grace trust was created in consideration of the trust previously established by the decedent, we think the burden has been met. It has been shown that the two trusts were not created to avoid estate taxes but merely as another step in a long-established pattern of family giving. Thus, since it has been shown that there was substance to the transactions and that they were not merely shams to avoid the imposition of estate taxes, the Janet Grace trust should not be included in the estate of the decedent. Accordingly, plaintiffs are entitled to recover, with the amount of the recovery to be determined pursuant to Rule 47(c).

DAVIS, Judge, dissenting:

I

1. Even on the court's own assumption that subjective motivation is all-controlling, the judgment should go for the Government. Under the rule of the first "line of cases" (as formulated in the majority opinion), I cannot escape the conclusion that Mr. and Mrs. Grace did give "consideration" to each other in the sense that the establishment of each trust was the quid pro quo for the other, and was intended as such. There is, first of all, the basic finding, adopted by the court, that the trusts "were created by, or at the instigation of, Joseph P. Grace as parts of what was essentially a single transaction." Finding 53. This is far from an overstatement. The decedent was the sole decision-maker in the household; his wife accepted his choices without question, even for her property. Finding 5(a). The creation of two trusts in December 1931 followed this pattern (findings 10 and 45), and there is no possibility that Janet Grace was pursuing an independent course. The two trusts, moreover, were obviously inter-connected; Joseph developed the idea of both at the same time, he had his attorney draw them up simultaneously (findings 10 and 45), the instruments contained very similar provisions and were the same in form (findings 11(a), 12(a), and 13), they were both executed within a short period of time, and both covered substantial properties (findings 11 and 12).[3]

[3] See also the evidence referred to infra as to the decedent's probable tax motivation and the departure from the type of gifts the Graces had been making in the past or would make in the future.

The findings that the trust instrument were signed 15 days apart (findings 11(a) and 12(a)), and that no attempt was

It follows in common sense, as I gauge it, that one of these inter-related trusts was in exchange for the other, one settlor was actually "paying for" the transfer made by the other. Of course, the Graces did not desire to acquire property from one another (finding 15) but neither did the Lehman brothers in the seminal decision and neither do the parties to any reciprocal trust arrangement. That is almost an irrelevant factor since the mutuality is all-important to the parties, not the property content of the individual transfers if they were isolated. Of course, Mrs. Grace as a person was not induced or caused to establish her trust by the previous establishment of Joseph's trust. See finding 12(e). But he was her agent and acted for her in this as in all financial transactions—and *he* obviously wanted the trusts to be related, connected, and interdependent. Since Joseph was the only real moving party and Janet was wholly acquiescent, it is immaterial that there is no evidence of a factual "bargain" between them (see finding 30), or even a tacit understanding (finding 29), and that, quite likely, Janet Grace had no knowledge of her husband's trust (finding 12(e)). It cannot be that the law frees from estate tax a reciprocal trust arrangement where, as here, the wife is the submissive

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made to equalize the value of the trust corpora (finding 45(g)) do not swing the balance the other [illegible]. The latter would be pertinent for transfers between spouses only in very special circumstances since the distribution of assets between husband and wife is rarely of great consequence and spouses infrequently deal with each other at arm's length. Compare *Estate of Ruxton*, 20 T.C. 487, 494 (1953), with *Cole's Estate* v. *Commissioner*, 140 F. 2d 636, 638 (C.A. 8, 1944). The first is insignificant in light of the finding that the instruments were drafted at about the same time. See *Orvis* v. *Higgins*, 180 F. 2d 537 (C.A. 2), cert. denied, 340 U.S. 810 (1950) (6 day gap); *Estate of Carter*, 31 T.C. 1148, 1151–53 (1959) (1 day); *Estate of Eckhardt*, 5 T.C. 573, 678–79 (1945) (6 days).

instrument of her husband, while imposing the levy where the wife is a sovereign soul who, though making up her own mind, agrees with her spouse to adopt the cross-trust device. Gentlemen with compliant Biancas at their side instead of independent Katherines may enjoy some advantages, but certainly not that one.

2. A separate line of cases, in the court's view, stresses tax avoidance, but the court concludes that "the reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace and to have his wife create the Janet Grace trust * * *." My judgment, to the contrary, is that the taxpayers have failed to bear their burden of proving the absence of estate tax motivation.[4]

The majority concludes that this motive is negated, in the main, by the facts that Joseph Grace desired to avoid the impending gift tax (findings 10 and 15), and that the Graces had a longstanding practice of intra-family donations (findings 7–9 and 16–17), including a great number of trusts (finding 32). However, the wish to by-pass the gift tax is by no means inconsistent with a desire to avoid the estate tax as well, especially when, as is conceded, both trusts were deliberately part of a single undertaking. Cf. *Orvis* v. *Higgins, supra*, 180 F. 2d 537, reversing 80 F. Supp. 64, 72, 74 (S.D.N.Y. 1948); *Estate of Carter, supra*, 31 T.C. at 1152. Nor does the history of intra-family generosity and the decedent's "trust-mindedness" support the conclusion. This pattern does not include, so

[4] The estate has the task of showing that it is entitled to recover under the governing rules. See *Orvis* v. *Higgins, supra*, 180 F. 2d at 541; *Estate of Eckhardt, supra*, 5 T.C. at 680; *Estate of Lindsay*, 2 T.C. 174, 177 (1943).

far as the findings show, a single reserved life estate to the other spouse, much less cross-life-estates, in property transferred to the children; nor does it show that the Graces had ever made simultaneous transfers to one another. The uniqueness of these two December 1931 transfers suggests strongly that they were linked to each other, not to any post or ante family practice, and that they had a special purpose. Cf. *Estate of Carter, supra,* 31 T.C. at 1154. No non-tax reason has been given us why, in this instance, the Grace pattern of generosity to kin worked itself out through this unusual mechanism of interdependent cross-trusts—and I can think of none.

True, there is no direct evidence that the decedent actually had tax avoidance in mind. We do know, however, that he thought and talked about the supposed tax advantages of concurrent trust transfers between spouses. Alan Ross, an executive in the Trust Department of the Grace National Bank, was an advocate of reciprocal trusts as a mode of minimizing estate taxes (findings 36 and 37(c)); though Joseph Grace was not proved to have had direct contact with Ross on this subject, he was aware of the Ross plan and discussed it with Harold J. Roig, an executive of W. R. Grace and Company and a confidant of Joseph's (Roig recommended against it) (findings 39 and 44); various Grace business executives and friends or relatives of the decedent either knew of and talked about the idea or had been approached by Ross to execute such trusts (findings 38–42);[5] contrary to

[5] Among those whom Ross tried to convert were Harold J. Roig (finding 39); W. R. Grace, brother of Joseph and a trustee for each of the Grace trusts involved here (finding 40); and D. S. Iglehart, president of the Grace company and a long-time friend of the decedent (finding 41). Apparently, of these, only Iglehart was inclined to follow Ross's plan. Findings 39–41. Although he did not hew to every aspect of the idea, the

decedent's custom, he presented J. Morden Murphy (who handled most of the Grace family's financial affairs) with a prepared draft of the Joseph Grace trust and possibly the Janet Grace trust for use as models (findings 35 and 45(f)); these drafts were very similar to the cross-trust instruments drawn by Alan Ross for D. Stewart Iglehart, a personal friend of Joseph Grace and president of W. R. Grace and Company (findings 41, 42, and 45 (f)) (see footnote 3). In addition, although this is not included in the findings, the draft trust instrument which Joseph brought with him, unlike any previously executed by him, designated the Grace National Bank as a trustee and—significantly—was prepared for the signature of Alan Ross on behalf of the bank.

This clear nexus between Joseph and the Ross tax-avoidance device—together with the lack of any other plausible reason for the cross-life-estates and their uniqueness in the Grace annals—persuade me of the probability that the decedent's actions had a distinct estate tax coloration. At a minimum, the plaintiffs have not succeeded, for me, in their job of persuasion.

II

1. But the most damaging crack in the foundation of the court's opinion comes from its hydraulic stress on subjective motivation far beyond its proper weight.

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evidence supports the conclusion that he hoped to save some estate taxes when he and his wife executed the trust instruments drawn by Ross. The scheme was also a topic of discussion among the personnel of the Customer Securities Department (J. Morden Murphy, and A. S. Rupley) and of the Legal Department (H. N. Deyo, A. B. Shea, and Cogswell). Finding 38. Finally, the record indicates that W. G. Holloway, a nephew of the decedent and a trustee on both trusts, knew of the plan although it is not clear whether he was fully aware of the estate tax implications.

Even though the trusts were admittedly part of one transaction, the court still seeks to find whether the settlors actually intended to induce each other to enter into the arrangement and to "pay for" the other's transfer, whether they actually intended to lessen estate taxes, and whether they were actually dominated by other motives. "Putting the wrong question is not likely to beget right answers even in law." *Vanston Bondholders Protection Comm.* v. *Green,* 329 U.S. 156, 170 (1946) (Frankfurter, J., concurring). As I understand the reciprocal trust doctrine stemming from *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2), cert denied, 310 U.S. 637 (1940), the correct question—once the cross-trusts are seen as inter-dependent (as has been found here)—is whether the trusts created by the two settlors put both in approximately the same economic position, objectively, as they would have been in if each had cr[illegible]d his own trust without invoking or using the other as beneficiary. See Lowndes, Consideration and the Federal Estate and Gift Taxes: Transfer for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts, 35 Geo. Wash. L. Rev. 50, 80 (1966). The essential purpose is to prevent a reciprocal arrangement from canceling the effect of an ostensibly complete inter vivos conveyance which on its face severs the settlor completely from the transferred assets.[6]

[6] The background of reciprocal trusts is discussed in Colgan & Molloy, Converse Trusts—The Rise and Fall of a Tax Avoidance Device, 3 Tax L. Rev. 271 (1948). Congress has, in effect, approved the doctrine's effort to close the loophole. In the Technical Changes Act of 1949, ch. 720, § 6, 63 Stat. 891, 893–94, it permitted those who had used the device prior to 1940 to give up their control over a reciprocal trust without paying a gift tax on the relinquishment. The Senate Finance Committee noted

The estate tax is, of course, designed to tax transfers of property made at death. Congress recognized, however, that such an impost could not be effective unless there were some restrictions on inter vivos transfers. Through Section 811 it sought to "include in the gross estate inter vivos gifts 'which may be resorted to, as a substitute for a will, in making disposition of property operative at death.'" *Helvering* v. *Hallock,* 309 U.S. 106, 114 (1940). We have been taught by *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701 (1949), that—once a "transfer" is shown—the critical test is the objective situation, not whether the decedent in his own mind resorted to the inter vivos transfer as a means of testamentary disposition.

In *Spiegel* the Court held, inter alia, that taxability under Section 811(c)(1)(C) "does not hinge on a settlor's motives, but depends upon the nature and the effect of the trust transfer." It is "immaterial" whether the interest upon which inclusion is premised "remains in the grantor because he deliberately reserves it or because, without considering the consequences, he conveys less than all of his property ownership." Any other approach, "such as a post-death attempt to probe the settlor's thoughts in regard to the transfer, would partially impair the effectiveness of the * * * provision as an instrument to frustrate tax evasions." 335 U.S. at 705–06. Although the Court was applying Section 811(c)(1)(C) (transfers "intended to take effect in possession or enjoyment" at the transferor's death), its reasoning applies with at least equal force to Section 811(c)(1)(B), involved

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that, prior to Lehman, the device had been used "with the apparent intent of minimizing estate taxes" and that Lehman "put taxpayers on notice as to the probable tax consequences of reciprocal trusts in the future." S. Rep. No. 831, 81st Cong., 1st Sess., at 5–6 (1949), reprinted in 1949–2 Cum. Bull. 289, 292.

here, which is framed in still more objective terms.[7]

If taxability turns on states of mind, the "difficulty of searching the motives and purposes of one who is dead" is likely to render estate taxes on inter vivos transfers "a weak and ineffective means of compensating for * * * the withdrawal of vast amounts of property from the operation of the estate tax." *Heiner* v. *Donnan,* 285 U.S. 312, 343 (1932) (Stone, J., dissenting); see *Bittker, The Church* and *Spiegel* Cases: Section 811(c) Gets a New Lease on Life, 58 Yale L.J. 825, 835–37 (1949). In addition, family arrangements which appear entirely comparable in their actual impact will receive different tax treatment dependent on amorphous testimony as to states of mind.

Avoidance of this danger by not inquiring into motives is more strongly justified when the truly non-tax reasons for a particular form of arrangement are rare, at best. Cross-trusts which are shown to be truly reciprocal definitely have this characteristic. Originally developed by enterprising attorneys during the 1930's as a tax avoidance device, nothing in their history indicates that they were engineered to fulfill any other function. See note 4 supra. Focusing on the beneficial interest or power granted to a decedent, one is hard put to find a purpose other than tax avoidance or, if the decedent was not fully aware of the tax implications, the aim of achieving some substitute for a will in disposing of property at death—to give the property at life's end but to keep a grasp on it while life lasts. See *Orvis* v. *Higgins, supra,* 180 F. 2d at 540–41; *Estate of Carter, supra,* 31 T.C. at 1153–54; *McLain* v.

[7] Even as to the word "intended", the Court pointed out in *Commissioner* v. *Estate of Church,* 335 U.S. 632, 638 (1949), that the historic test of "'intended' was not a subjective one, * * * the question was not what the parties intended to do, but what the transaction actually effected as to title, possession and enjoyment."

Jarecki, 232 F. 2d 211, 213–14 (C.A. 7, 1956) (dissenting opinion). The short of it is that, first, the obstacles to a fair determination of the actual subjective intent of the decedent are many and heavy; second, there is the highest probability that, by an interdependent reciprocal-trust arrangement, a decedent desires to avoid estate taxes or at least to achieve the type of transfer the estate tax is designed to assess (postponement until the transferor's death of relinquishment of his right to possess and enjoy the property); and, finally, in the remote instance in which the decedent has some other curious purpose, the objective fact, whether he knows or desires it or not, is that he is tieing a string to the very property he purports to give completely away.

2. This objective standard comes into play only after it is found that the cross-trusts are truly reciprocal,

[8] In *Spiegel* the Court held that an infinitesimal reversionary interest arising by operation of state law was enough to bring the transferred property within the decedent's gross estate under the portion of Section 811(c) covering transfers "intended to take effect in possession or enjoyment" at death. Shortly afterwards, Congress repudiated this particular result when applied to transfers made before October 8, 1949, by requiring (1) that the reversionary interest be expressly reserved in the trust instrument and (2) that the value of the interest exceed 5 percent of the value of the property transferred. See Technical Changes Act of 1949, ch. 720, § 7(a), 63 Stat. 891, 895, as amended by Technical Changes Act of 1953, ch. 512, § 207, 67 Stat. 615, 623. However, there is no indication that Congress, even through this express-reservation requirement, meant to make the transferor's subjective intent a crucial factor for taxation. See Bittker, Church and Spiegel: The Legislative Sequel, 59 Yale L.J. 395, 410 (1950). But cf. *Estate of Marshall*, 16 T.C. 918, 921–23 (1951), aff'd, 203 F. 2d 534 (C.A. 3, 1953). As for transfers after October 7, 1949, the statutes do not require that the reversionary interest be specifically reserved See Int. Rev. Code of 1954, § 2037(a)(2); Technical Changes Act of 1949, supra, § 7(a).

connected, interdependent; and in making the latter determination subjective intent does have its role. Clearly the estate tax permits a person during his lifetime to rid himself of property, and it also allows him to receive a beneficial interest in or power over the trust of another without necessarily having the corpus included in his estate. There is no doubt that this is true even if the chance effect of such independent transfers is to leave him in the exact situation he would have been in had he transferred his property retaining an interest or power similar to that granted by his benefactor. We can borrow an illustration from O. Henry's "Gift of the Magi", transforming it in milieu and feeling-tone. Suppose Janet Grace were a self-reliant woman and, consulting her own attorneys and advisers, independently and secretly decided to make a Christmas present to Joseph and her children in December 1931 by setting up the Janet Grace trust. Moved in the same way and unaware of Janet's plan, Joseph also decided, secretly, to make that kind of holiday gift to his family by establishing the Joseph Grace trust. On Christmas morning, the two executed trusts would appear to an outsider to be reciprocal and interdependent, but from the background we would know that that was not so. The appearance would mask the reality.

In the technical terms of the statute (§ 811(c)(1)(B)) the inquiry into true reciprocity and interdependence assesses whether the decedent made a "transfer", even though he was not the nominal settlor. If the cross-trust arrangement was mutual and interdependent, there is such a "transfer"; if the crossing of the trusts was haphazard, not pre-arranged, not part of a plan, there is no "transfer". To that extent the background of the transaction, including subjective motives, is relevant. Motivation is used to determine

the link between the trusts, and not, as a separate question, what the parties hoped or wanted to accomplish from their plan. The interdependence, in and of itself, furnishes the only "consideration" which the reciprocal trust doctrine should demand.

In the present case the findings and record show that the crossing was not haphazard but part of a single, interdependent transaction. See Part I of this opinion, supra. Accordingly there was a "transfer" by Joseph of the assets of the Janet trust, just as there was a "transfer" by Janet of the property in the Joseph trust. Those mutual transfers left Joseph, up to the limits of his wife's trust, in the same position as if he had given himself, rather than his wife, the life interest under the Joseph trust. If he had done that directly, the tax would admittedly be due under § 811 (c)(1)(B), no matter what his subjective motivation for creating the life interest. The estate should not escape because the same result came in more roundabout fashion. There is no need to delve further into Joseph Grace's intentions or motives.

3. This analysis is, I believe, consistent with the results, though not with all the language in a few of the opinions, in the estate tax reciprocal-trust cases of which we are aware.[9] The basic rationale of many, probably most, of the decisions is affirmatively in accord. Included are those cases emphasizing interdependence and, once that is found, holding the tax due without much more in the way of facts.[10] Quite

[9] I do not discuss the non-estate tax cases, which often present complicating problems.

[10] See *Estate of Moreno* v. *Commissioner*, 260 F. 2d 389, 392 (C.A. 8, 1958); *Orvis* v. *Higgins*, *supra*, 180 F. 2d at 540; *Hanauer's Estate* v. *Commissioner*, 149 F. 2d 857, 858 (C.A. 2), cert. Denied, 326 U.S. 770 (1945); *Estate of Carter*, *supra*, 31 T.C. at 1154; *Estate of Newberry*, 6 T.C.M. 455 (1947), aff'd per curiam, 172 F. 2d 220 (C.A. 3, 1948); *Estate of Eck-*

explicit are *Cole's Estate* v. *Commissioner, supra,* 140 F. 2d 636, and *Hanauer's Estate* v. *Commissioner, supra,* 149 F. 2d 857. Cole's Estate upheld a Tax Court decision "based upon the legal effect of the trust agreements coupled" with the finding that " 'the property of the wife was in effect exchanged for that of the husband.' " 140 F. 2d at 637, 638. It further held that " 'with few exceptions the law attaches legal consequences to what the parties do quite independently of their private purpose or intent.' " 140 F. 2d at 638. Similarly, *Hanauer's Estate, supra,* concluded that "the two trust indentures were contemporaneously developed and executed as though all part of a single transaction" and that, "[t]here being no contention that the decedent's transfer was one in contemplation of death, his motive was not controlling." 149 F. 2d at 859.

The few opinions which seem to insist, in part, on a conscious, subjective bargain-and-exchange seem to rest on a determination that the crossed trusts were not in fact interdependent. In *Newberry's Estate* v. *Commissioner,* 201 F. 2d 874, 875 (C.A. 3, 1953), the husband gave unrebutted testimony "that he would have created his trusts regardless of whether Mrs. Newberry had decided upon a similar course." The trusts were created fifteen months apart in *In re Leuders' Estate,* 154 F. 2d 128, 132 (C.A. 3, 1947), and there was very little indication of interdependence. *McLain* v. *Jarecki,* 232 F. 2d 211, 213 (C.A. 7, 1956), is not so clear, but the court seems to have treated the "donative state of mind once extant" be-

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hardt, supra, 5 T.C. at 680, 682; *Estate of Fish,* 45 B.T.A. 120, 125 (1945); *cf. Blackman* v. *United States,* 98 Ct. Cl. 413, 426–27, 48 F. Supp. 362, 368 (1943). Compare *Estate of Buxton, supra,* 20 T.C. at 494; *Estate of Resch,* 20 T.C. 171, 183 (1953); *Estate of Lindsay, supra,* 2 T.C. at 177, 179.

tween the spouses as showing that each was pursuing an independent course.[11] "The decisions are thus distinguishable, but to the extent the opinions reflect adherence to the narrow view that an actual subjective bargain is necessary, I would reject them as contrary to the aims of the estate tax provisions on inter vivos transfers and out of harmony with the bulk of the jurisprudence on this point.

For these reason, I dissent and would hold that the taxpayers are not entitled to recover.

NICHOLS, Judge, joins the foregoing dissenting opinion.

FINDINGS OF FACT

1. This case is a suit for refund of Federal estate taxes and interest thereon paid by the Estate of Joseph P. Grace, Deceased.

2. Joseph P. Grace, the decedent whose estate is here involved (hereinafter sometimes called "the decedent"), and Janet Grace were husband and wife. They were married in August 1908.

3. (a) The following children, born on the dates indicated, are the surviving offspring of the marriage of the decedent and Janet Grace:

Joseph Peter Grace, Jr. (hereinafter sometimes called "Peter"), May 25, 1913.

Michael P. Grace, II (hereinafter sometimes called "Michael"), August 6, 1917.

Janet Maureen Grace (hereinafter sometimes called "Maureen"), December 27, 1924.

Charles MacDonald Grace (hereinafter sometimes called "Charles"), September 13, 1926.

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[11] Estate of *Guenzel* v. *Commissioner*, 258 F. 2d 248, 252, 254 (C.A. 8, 1958), contains dicta suggesting the bargain-and-exchange approach, but also quotes the broader formulation of *Cole's Estate*, *supra*.

(b) Another child, Nora Grace (hereinafter sometimes called "Nora"), was born to the decedent and Janet Grace. Nora died on August 25, 1935.

4. The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not thereafter inherit any substantial wealth. However, as indicated in subsequent findings, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers made by the decedent to her.

5. (a) The decedent exercised supervision and control over, and he made the decisions that were involved in the management of, the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or disposition of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument.

(b) In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Company to assist him

by handling the details that were involved in carrying out his decisions.

6. (a) Beginning in about 1911 and continuing thereafter as long as the decedent and Janet Grace lived, their family homestead was a large country estate known as Tullaroan, which was situated near Lakeville in the town of North Hempstead, Nassau County, Long Island, New York. When Tullaroan was first acquired for the Grace family on April 5, 1911, it consisted of a substantial farmhouse located on approximately 167 acres of land. The decedent promptly undertook the development and improvement of the property into a homestead for his family. The improvements ultimately included a 65-room colonial-style house for the family residence, several smaller dwellings for members of the household staff, an indoor tennis court, two swimming pools, a polo field, three greenhouses, a garage, a stable, a dog kennel, two cow barns, a bull pen, a pig sty, two chicken houses, and a well and pumphouse to provide a water system for the property. The grounds around the main house were extensively terraced and landscaped.

(b) The decedent paid the purchase price for Tullaroan when it was acquired on April 5, 1911, although title to the property was taken in the name of Janet Grace. The decedent also paid for the construction of the buildings and other improvements at Tullaroan, except that the decedent's uncle, Michael P. Grace, paid for substantial additions to the main residence in about 1920.

7. (a) During the period between April 19, 1917, and July 20, 1926, the decedent transferred property and financial interests to Janet Grace, as indicated in the following table:

Date of transfer	Property transferred	Book value
4-19-17	3,000 sh. Ingersoll-Rand Co	$300,000.00
5-12-17	1,600 sh. W. R. Grace & Co. 2d. Pfd	160,000.00
5-12-17	1,600 sh. W. R. Grace & Co., Common	160,000.00
6-14-18	250 sh. Ingersoll-Rand Co	25,000.00
6-14-18	1,000 sh. W. R. Grace & Co., Common	100,000.00
3-27-19	20,000 sh. Grace Bros. & Co., Ltd	48,686.00
3-27-19	1,106 sh. W. R. Grace & Co., 2d. Pfd	114,100.00
3-27-19	1,500 sh. Ingersoll-Rand Co	150,000.00
12-31-19	1,000 sh. W. R. Grace & Co., Common	100,000.00
12-31-19	1,000 sh. Ingersoll-Rand Co	100,000.00
12-31-20	Smoketown Property	4,409.73
5-3-22	325 sh. Ingersoll-Rand	32,500.00
6-5-22	50 sh. A&P SS Co., Common	5,000.00
6-6-22	334 sh. W. R. Grace & Co., 2d. Pfd	33,400.00
11-8-23	756 sh. W. R. Grace & Co., Pfd	75,600.00
11-8-23	50 sh. The Evergreens	6,435.00
11-8-23	150 sh. Terminal Whse. Co	9,104.46
11-8-23	400 sh. National City Bank of N.Y	113,148.50
11-8-23	100 sh. National City Co	no value.
11-8-23	66 sh. Lincoln Safe Deposit Co	12,660.00
12-20-23	Cash	25,000.00
7-20-26	Cash (loans treated as gifts)	135,000.00
7-20-26	Tennis Court Building	97,725.97

(b) On May 10, 1929, the decedent deeded to Janet Grace a large tract of land known as the Arthur Farm Property, which was located immediately adjacent to Tullaroan. At the time of the transfer, this property had a book value of $72,715.18.

8. (a) During the period between August 26, 1920, and June 5, 1930, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Peter	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Michael	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Nora	$97.37
1-15-25	8,000 sh. Grace Bros. & Co., Ltd	Maureen	24,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Peter	3,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Michael	3,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Nora	3,000.00
2-17-26	1,000 sh. Grace Bros. & Co., Ltd	Maureen	3,000.00
7-9-26	666 sh. Ingersoll-Rand Co.	Maureen	22,282.82
12-1-27	800 sh. Ingersoll-Rand Co.	Nora	18,453.68
1-5-28	966 sh. Ingersoll-Rand Co.		
	166 sh. W.R. Grace & Co., Common		
	9,000 sh. Grace Bros. & Co., Ltd		
	15 sh. The Evergreens		
	$5,000 Lake Shore Michigan, So. 4% 1928		
	5,000 United Kingdom 5½% 1937		
	2,000 Mead Pulp & Paper 5% 1934		
	1,000 Ingersoll-Rand Co. 5% 1935		
	1,000 Grace Nitrate Co. 6% 1942		
	3,000 Terminal Warehouse 5% 1942	Charles	60,210.44
4-30-29	60 sh. United Aircraft & Transport Corp	Peter	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Michael	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Nora	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Maureen	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Charles	1,800.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Janet	750.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Charles	750.00
4-4-30	20 sh. Lundy's Lane Corp	Peter	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Michael	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Nora	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Maureen	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Charles	107,281.71
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Peter	750.00
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Michael	750.00
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Nora	750.00

9. During the period between August 26, 1920, and March 31, 1929, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children.

Date	Book value	Description
8-26-20	$100,000.00	20,000 shares Grace Bros. & Co., transferred to account of children.
12-21-24	25,000.00	Transfer to Joseph P. Grace and Janet Grace, as Trustees for Maureen.
9-1-26	10,000.00	Joseph P. Grace, loan-gifts
1-5-28	3,860.15	35 shares, The Evergreens, gift Joseph P. Grace.
3-31-29	613,344.32	Gift to Joseph P. Grace, 200 shares of Lundy's Lane Corp.

10. In early December of 1931, the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company (see finding 5(b)), concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with the transfers of assets to the trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships; and the decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the ownership of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had with him drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

11. (a) Following the conference with J. Morden Murphy referred to in finding 10, and in accordance with the plan of the decedent mentioned in that finding, the decedent on December 15, 1931, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Joseph Grace trust." This trust instrument provided in part as follows:

> I, Joseph P. Grace, River House Rd., Manhasset of the County of Nassau, State of New York, hereby constitute William R. Grace, Old Westbury Rd., Old Westbury; William G. Holloway, Store Hill Rd., Old Westbury; and

Joseph P. Grace, Power House Rd., Manhasset and their successors Trustees of the property described in Schedule "A" hereunto annexed, which property I have transferred, delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations.

First: I direct the said Trustees to hold the same in trust during the life of my wife, Janet Grace, and to pay the entire net income therefrom to her during her life, together with any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time in their sole discretion deem advisable.

Second: I direct the said Trustees, upon the death of my said wife, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such one or more of our issue and myself as my said wife may by will or deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as she may provide in such appointment, or to the extent that she may not effectively appoint the same, to pay the same to our issue then surviving in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said wife a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I reserve during my life and I give to my said wife after my death the right to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property, real or

personal, in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further reserve during my life and I give to my said wife after my death the right to direct the exchange of any property, real or personal, held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property, and through the voting of proxies issued to me and/or my nominees or after my death to my said wife and/or her nominees by authority hereof, to manage and control any corporation the stock of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the individual Trustees herein named or of any of their successors, I direct that my said wife, or, if she be dead, the remaining Trustees shall have the power to name an individual or a bank or corporation empowered by law to act in such a capacity, to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, the decedent on December 15, 1931, transferred to the Joseph Grace trust the following assets, previously selected by the decedent as indicated in finding 10: 300 shares of the capital stock of the Gilchrest Realty Corporation; 329⅙ shares of the capital stock of Belgrave Realty, Inc.; 150 shares of the capital stock of

the Thomaston Corporation; certain real estate referred to as Thomaston Cottage #5, Bell-Brookhaven-Lot 26, 310–312 East 37th Street, and the Yaphank property; and a one-fourth undivided interest in a certain joint venture known as the Grace Harbor Account.

(c) The Gilchrest Realty Corporation was a real estate development company whose assets consisted principally of improved and unimproved properties located on Long Island, New York, including unimproved lots held for sale and improved commercial rental properties, most of which represented the remaining unsold portion of a 58-acre tract of land, with buildings, known as Smith Farm, which the corporation had acquired at the time of its organization in 1916 and had subsequently subdivided, sold lots out of, constructed additional buildings and improvements upon, and otherwise dealt with, plus real estate mortgages derived from sales of such property. The 300 shares of Gilchrest Realty Corporation transferred by the decedent to the Joseph Grace trust represented 20 percent of the 1,500 shares then outstanding, and were all of the shares of the Gilchrest Realty Corporation which the decedent owned. The decedent had acquired 294 of these shares by gift from Lillius Grace, his mother, in 1917, had received 1 share from her estate in 1923, and had purchased 5 shares in or about 1917. The decedent received no dividends on this stock while it was held by him, nor were any dividends received on this stock by the Joseph Grace trust from the date of the creation of that trust to its termination on December 31, 1937.

(d) Belgrave Realty, Inc., was a real estate development corporation whose assets consisted principally of the remaining unsold portion of a 59-acre tract of land located on Long Island, New York, and

known as Allen Farm, which the corporation had acquired in 1916 and had subsequently subdivided and sold lots out of, as well as mortgages and cash derived from the sale of lots. The 329⅛ shares of Belgrave Realty, Inc., which the decedent placed in the Joseph Grace trust represented 21.94 percent of the 1,500 shares then outstanding, and were all of the shares of Belgrave Realty, Inc., which the decedent then owned. The decedent had acquired 100 shares of this stock from his mother's estate in 1926, 166⅔ shares were distributed to him by a holding company in 1927, and 50 shares and 12½ shares were received in 1929 and 1930, respectively, from the estate and a testamentary trust under the will of his uncle, Michael P. Grace. No dividends were received by the decedent from Belgrave Realty, Inc., while he held this stock, but the Joseph Grace trust received certain "extraordinary dividends" thereon in 1933 and 1937.

(e) The Thomaston Corporation was a holding or investment company whose assets consisted of common and preferred stocks of various corporations. The 150 shares of Thomaston Corporation stock which the decedent transferred to the Joseph Grace trust on December 15, 1931, represented 19.74 percent of the 760 shares then outstanding, all of which were owned by the decedent prior to that transfer in trust. The decedent had acquired all of the 760 shares on November 8, 1923, in exchange for securities transferred to the corporation. The 150 shares of Thomaston Corporation were distributed to Janet Grace on April 27, 1932, upon directions from the decedent and one of the other two trustees, "in accordance with the power conferred upon them by the first clause of the indenture of 12/15/31." On the same date, Janet Grace made a gift of the same 150 shares of Thomaston Corporation to the decedent.

(f) The real properties referred to as Bell-Brookhaven-Lot 26 and the Yaphank property were unimproved lands situated in the town of Brookhaven, Suffolk County, Long Island, New York. The Yaphank property was a large tract of about 1,000 acres. Bell-Brookhaven-Lot 26 consisted of a long, narrow strip between Great South Bay and the Atlantic Ocean, about 125 feet in width and running about 1,251 feet in length between the two bodies of water. Bell-Brookhaven-Lot 26 had been purchased by the decedent on December 21, 1926, at a cost of $56,905.32. The Yaphank property had been purchased by the decedent on August 24, 1928, at a cost of $69,532.50.

(g) The properties known as Thomaston Cottage #5 and 310–312 East 37th Street were improved rental properties having market values of $3,750 and $47,500, respectively, at the date of the creation of the Joseph Grace trust. Thomaston Cottage #5 had been owned by the decedent since July 6, 1893, when he acquired it by deed from his mother, Lillius Grace. The 310–312 East 37th Street buildings had been purchased by the decedent on May 2, 1928, at a total cost of $65,737.16.

(h) The Grace Harbor Account was a real estate development joint venture formed on October 1, 1927, between the five beneficiaries under the will of the decedent's mother, Lillius Grace, and the Gilchrest Realty Corporation, whereby certain real estate belonging to the estate was transferred to the corporation, which undertook to develop, improve, and sell the property, accounting to the beneficiaries for the proceeds thereof; and there was also transferred to the corporation, for the purpose of financing development costs, certain mortgages and 13,275 shares of the common stock of Ingersoll-Rand Company, in which

each of the beneficiaries owned an undivided one-fifth interest. The decedent originally owned an undivided one-fifth interest in the Grace Harbor Account; but one of the five owners withdrew in 1928, leaving the decedent owning a one-fourth undivided interest, which he placed in the Joseph Grace trust. At the time of the creation of the Joseph Grace trust, the assets of the Grace Harbor Account consisted principally of the unsold (or sold and reacquired) portion of a tract of land known as Gracefield or Grace Harbor, a number of real estate mortgages, other receivables and cash, and 10,620 shares of Ingersoll-Rand common stock. Gracefield or Grace Harbor originally consisted of about 177 acres, but this tract had been developed and portions of it had been sold prior to the creation of the Joseph Grace trust.

12. (a) On December 30, 1931, Janet Grace, acting in accordance with the plan of the decedent mentioned in finding 10, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Janet Grace trust." The trust instrument provided in part as follows:

> I, Janet Grace, of the County of Nassau, State of New York, hereby constitute William R. Grace, William G. Holloway and Janet Grace and their successors Trustees of the property described in Schedule "A" hereunto annexed, which property I have transferred and delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations:
>
> *First:* I direct the said Trustees to hold the same in trust during the life of my husband Joseph P. Grace and to pay the entire net income therefrom to him during his life together with any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them

may at any time or from time to time deem advisable. I further direct that during the life of my said husband he shall be entitled to the use and occupancy of the real property described in Schedule "A" hereunto annexed or such part thereof as shall not have been conveyed to him in fee pursuant to the provisions of the clause "First".

Second: I direct the said Trustees, upon the death of my said husband, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to ~~or~~ for the benefit of such one or more of our issue and myself as my said husband may by Will or Deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as he may provide in such appointment, or to the extent that he may not effectively appoint the same, to pay the same to our issue then surviving, in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said husband a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I give to my said husband the right during his life and I reserve the right after his death to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property real or personal in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further give to my said husband the right during his life and I reserve the right after his death to direct the exchange of any property, real or personal held hereunder for the stocks, bonds or other securities of any corporation

to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property and through the voting of proxies issued to my said husband and/or his nominees or after his death to me and/or my nominees by authority hereof, to manage and control any corporation, the stock of which may at any time be held hereunder. Any such direction made by my said husband or after his death by me shall be in writing and the Trustees are hereby specifically released from all liability for any loss arising from any action taken or omitted to be taken by them at the direction of my said husband or after his death at my direction and from any action taken or omitted to be taken by my said husband and/or his nominees or after his death by me and/or my nominees pursuant to any proxy or proxies issued at his direction and with respect to any corporation controlled by him, the stocks, bonds or other securities of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the Trustees herein named or of any of their successors, I direct that my said husband, or if he be dead, the remaining Trustees shall have the power to name an individual or a bank or corporation empowered by law to act in such a capacity to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, Janet Grace on December 30, 1931, transferred

to the Janet Grace trust the following assets, previously selected by the decedent as indicated in finding 10: Tullaroan (see finding 6) and 40 shares of stock in a certain corporation known as Lundy's Lane Corporation.

(c) At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan during their lives; and, in fact, both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust.

(d) Lundy's Lane Corporation was a personal holding company incorporated on behalf of Janet Grace on November 9, 1923, at which time she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock and 3,040 shares of W. R. Grace and Company second preferred stock. All of the latter securities had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of Lundy's Lane Corporation stock originally owned by Janet Grace (which were all of the outstanding shares of the corporation at all times material to this litigation), Janet Grace made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totaling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. On December 30, 1931, immediately prior to the creation of the Janet Grace trust, Janet Grace owned 407 shares of the stock of Lundy's Lane Corporation; and after the transfer of 40 shares to

that trust on December 30, 1931, the stock was held as follows:

	Shares
Janet Grace trust	40
Decedent	100
Five trusts for children (20 shares each)	100
Janet Grace	367
Total stock outstanding	607

(e) There is nothing in the evidence to indicate that Janet Grace, when she signed the instrument creating the Janet Grace trust and transferred property to that trust, was aware that the decedent had created the Joseph Grace trust.

13. The similarity between the trust instruments creating the Joseph Grace trust and the Janet Grace trust, as indicated in findings 11(a) and 12(a), also obtained with respect to the portions of the respective trust instruments which have been omitted from the findings.

14. At the time of the creation of the Janet Grace trust on December 30, 1931, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,633,113.26 on December 31, 1931, after the creation of the Janet Grace trust.

15. In connection with the creation of the Joseph Grace trust and the Janet Grace trust, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences.

16. (a) Subsequent to the creation of the Joseph Grace trust on December 15, 1931, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
12-28-35	$20,000.00 Gilchrest Realty Corp., 2½% Notes due April 1, 1921.	Maureen	$20,000.00
12-28-35	Two parcels of real property in Manhasset, Nassau Co., N.Y.; 112 sh. W. R. Grace & Co., Pref.; 238 sh. W. R. Grace & Co. Pref.	Maureen and Charles.	66,955.00
12-31-35	6 sh. Lundy's Lane Corp.	Michael	53,258.46
12-2-37	100 sh. Ingersoll-Rand Co.	Peter	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co.	Michael	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co.	Maureen	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co.	Charles	9,450.00
2-21-38	8% interest in real property situated at Northwest, Town of Easthampton, Suffolk Co., N.Y.	Maureen and Charles.	7,307.03
11-24-39	4,000 sh. Ingersoll-Rand Co.	Maureen and Charles.	197,134.48

(b) In addition to creating the trusts referred to in paragraph (a) of this finding, the decedent subsequent to December 15, 1931, transferred assets directly to his children, as follows:

Date	Property transferred	Transferee	Book value
10-20-37	¼ share Lundy's Lane Corp	Peter	
10-20-37	¼ share Lundy's Lane Corp	Michael	
10-20-37	¼ share Lundy's Lane Corp	Maureen	$10,728.17
10-20-37	¼ share Lundy's Lane Corp	Charles	
9-11-39	225 sh. W. R. Grace & Co., Common	Peter	
9-11-39	225 sh. W. R. Grace & Co., Common	Michael	
9-11-39	225 sh. W. R. Grace & Co., Common	Maureen	69,981.32
9-11-39	225 sh. W. R. Grace & Co., Common	Charles	
11-24-39	2,000 sh. Ingersoll-Rand Co	Michael	
11-24-39	2,000 sh. Ingersoll-Rand Co	Peter	197,134.48
12-4-40	200 sh. Ingersoll-Rand Co	Peter	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Michael	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Maureen	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Charles	3,400.00
12-24-40	250 sh. Ingersoll-Rand Co	Peter	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Michael	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Maureen	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Charles	4,250.00
5-13-41	500 sh. Ingersoll-Rand Co	Peter's wife	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Michael	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Maureen	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Charles	8,500.00
5-14-42	40 sh. Northern Ins. Co	Peter	
5-14-42	40 sh. Northern Ins. Co	Michael	
5-14-42	40 sh. Northern Ins. Co	Maureen	6,400.00
5-14-42	40 sh. Northern Ins. Co	Charles	
5-14-42	¼ int. Lakeville Vanhorn Prop	Peter	
5-14-42	¼ int. Lakeville Vanhorn Prop	Michael	
5-14-42	¼ int. Lakeville Vanhorn Prop	Maureen	2,910.13
5-14-42	¼ int. Lakeville Vanhorn Prop	Charles	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Peter	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Michael	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Maureen	455.25
5-14-42	¼ int. Blakeley Valley Rd. Prop	Charles	

17. Subsequent to December 30, 1931, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children:

Date	Book value	Description
4-27-32	$173,434.50	Gift to Joseph P. Grace, 150 shares Thomaston Corp., cap. stock.
12-28-35	180,268.89	Donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Maureen and Charles, 114 sh. W. R. Grace & Co., Pfd., stock, ½ interest in Providence Island Property, 38% interest in a certain $330,523.40 mortgage.
12-31-35	10,728.17	2 shares Lundy's Lane Corp. stock donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Michael.
12-31-36	24,971.30	13,350 shares Grace Bros. & Co., Ltd., gifts to Joseph P. Grace and Janet Grace, as Trustees under instruments dated 8/26/20, 8/26/20, 1/15/25, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively, 3,339 each.
10-20-37	10,728.17	Gifts to each of four children of 2 shares, in all, of Lundy's Lane Corp.
12- 2-37	15,310.00	Gifts of 400 shares of National City Bank to Janet Grace and Joseph P. Grace, as Trustees of 4 trusts created 8/26/20, 8/26/20, 1/5/20, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively (100 shares each).

18. (a) Janet Grace died on December 31, 1937, at the age of 53 years.

(b) At the time of her death, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,550,131.04. Her gross estate (excluding the Janet Grace trust) was valued for Federal estate tax purposes at a total value of $5,550,481.78.

19. Janet Grace continued to act as one of the three trustees of the Janet Grace trust until her death. On January 13, 1938, the decedent, pursuant to a power vested in him under the terms of the trust instrument, appointed Joseph P. Grace, Jr., as successor trustee in the place and stead of Janet Grace, by reason of her death. By reason of the death of another of the original trustees, William R. Grace, on March 31, 1943, Daniel C. Keefe was appointed on May 20, 1943, as successor trustee in the place and stead of William R. Grace, and accepted the appointment on May 21, 1943. From the latter date until

the death of the decedent, William G. Holloway, Joseph P. Grace, Jr., and Daniel C. Keefe continued to act as trustees of the Janet Grace trust. The decedent was never a trustee of the Janet Grace trust.

20. (a) During the 6-year period between the creation of the Joseph Grace trust on December 15, 1931, and the death of Janet Grace on December 31, 1937, income from that trust in the amount of $72,908.45 was paid to Janet Grace pursuant to the terms of the Joseph Grace trust.

(b) At the time of Janet Grace's death, the Joseph Grace trust had on hand undistributed income in the amount of $60,719.28.

(c) A distribution of corpus having a book value of $173,434.50 was made to Janet Grace during her lifetime pursuant to the terms of the Joseph Grace trust.

21. (a) After the death of Janet Grace, her estate filed a Federal estate tax return, in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the latter asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by (1) a reduction in the value, as shown on the return, of the shares of stock in Lundy's Lane Corporation owned by Janet Grace at the date of her death, (2) a reduction in the value, as shown on the return, of the shares of stock in W. R. Grace and Company owned by Janet

Grace at the date of her death, and (3) elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. This added $336,783.70 to the taxable estate of Janet Grace. As part of the compromise agreement, the estate of Janet Grace abandoned its counter-contentions, as summarized earlier in this finding.

(b) The compromise agreement referred to in paragraph (a) of this finding involved a reciprocal yielding of positions by both sides. The position yielded by the estate of Janet Grace approximated in monetary terms the position yielded by the Internal Revenue Service with respect to 45 percent of the value of the Janet Grace trust. Thus, the effect of the compromise agreement was to include the full appraised value of the corpus of the Janet Grace trust at the time of Janet Grace's death, or $612,334, as part of the taxable estate, and to adjust the valuations of other assets of the estate downward by 45 percent of the amount just stated.

(c) In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in paragraph (a) of this finding, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the value of the lesser trust, i.e., the Janet Grace trust, that would be taxable as part of the estate of Janet Grace.

22. The decedent died on July 15, 1950, at the age of 73 years.

23. During the period of approximately 18½ years that intervened between the creation of the Janet Grace trust on December 30, 1931, and the decedent's death on July 15, 1950, a total of $389,465.04 was paid to Joseph Grace pursuant to the terms of the Janet Grace trust.[12] In addition, as indicated in finding 12(c), the decedent had the use and enjoyment of Tullaroan as his family home until the time of his death.

24. (a) After the death of the decedent, a Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent. The trust instruments creating the Joseph Grace trust and the Janet Grace trust were attached to the return as exhibits.

(b) Following an examination of the return referred to in paragraph (a) of this finding, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

[12] Of this total, the amount of $47,825.18 was distributable to the decedent during the lifetime of Janet Grace.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate.

(c) The deficiency of $363,500.97 mentioned in paragraph (b) of this finding, plus assessed interest in the amount of $55,720.08, or a total of $419,221.05 was paid by the decedent's estate on July 14, 1954.

25. Under the date of July 13, 1956, there was filed with the appropriate District Director of Internal Revenue, on behalf of the Estate of Joseph P. Grace, Deceased, a claim for "Refund of Taxes Illegally, Erroneously or Excessively Collected." The claim for refund stated in part as follows:

> Michael P. Grace, II, one of the executors of the Estate of Joseph P. Grace, Deceased (date of death July 15, 1950), is filing this claim for refund for and on behalf of said Estate. As a result of a tax examination of the U.S. Estate Tax return form 706 filed by the Estate of Joseph P. Grace, Deceased, an additional tax of $363,500.97 was assessed in 1954 and this entire amount was paid on July 14, 1954 together with interest of $55,720.05.
>
> The additional tax resulted from the fact that the Revenue Agent's Report in connection with the aforementioned examination increased the Estate's valuation by $1,116,888.62 which allegedly "represents reciprocal trust made by decedent's wife Janet on December 31, 1931 for the benefit of decedent." The R.A.R. stated that the aforestated amount was "includible in the gross estate under Section 811(C) of the Internal Revenue Code."
>
> This claim for refund is based on the contention that the aforestated trust was not a reciprocal trust and that same was not includible in the Estate of Joseph P. Grace under Section

811(C) or under any other Section of the Internal Revenue Code.

* * * * *

This claim is for the amount of $419,221.02 plus interest from July 14, 1954. * * *

26. The claim on which this suit is based, as set out in finding 25, had not been disallowed at the time when the petition was filed, and more than 6 months had elapsed since the filing of the claim. No part of the sum so claimed has been credited, refunded, or repaid.

27. The plaintiffs Michael P. Grace II, Joseph Peter Grace, Jr., and Charles MacDonald Grace are the duly qualified and acting executors of the decedent's estate, and as such are qualified to bring this suit.

28. This court has jurisdiction of the case.

29. The Joseph Grace trust and the Janet Grace trust were not created, and properties were not transferred to these trusts, pursuant to any agreement, express or implied, between the decedent and Janet Grace to make reciprocal transfers of properties.

30. The transfer of property by the decedent to the Joseph Grace trust was not in consideration of the transfer of property by Janet Grace to the Janet Grace trust; and the transfer of property by Janet Grace to the Janet Grace trust was not in consideration of the transfer of property by the decedent to the Joseph Grace trust.

31. In financial matters, Joseph P. Grace was very generous to his wife, Janet Grace. During the period 1911–1929, Mr. Grace transferred (or caused to be transferred) to Mrs. Grace real estate and securities of great value, as well as large amounts of cash (see findings 4, 6, and 7). Janet Grace had practically nothing in the way of wealth when she married

Joseph P. Grace, and as a result of his generosity, she ended up having approximately as much wealth as he did. Indeed, Mr. Grace's transfers of income-producing properties to Mrs. Grace were so extensive that ultimately he became worried over whether the income-producing properties still in his possession would be sufficient to defray the annual expenses for which he was responsible, amounting to at least $200,000 per year. Because of this worry, Mr. Grace had Mrs. Grace retransfer to him some securities that he had previously given to her. For example, on March 31, 1929, Mr. Grace had Mrs. Grace retransfer to him 200 shares of stock in the Lundy's Lane Corporation, having a book value of $613,444.32 (see finding 9). Notwithstanding such retransfers, Mrs. Grace still owned extremely valuable properties as the result of gifts originally received from Mr. Grace.

32. In his relations with his children, Joseph P. Grace was both generous and "trust minded" (see findings 8 and 16). He apparently was motivated by a desire to equalize benefits among the various children.

33. In establishing trusts for the benefit of his children, Joseph P. Grace dealt with J. Morden Murphy, head of the Customers Securities Department of W. R. Grace and Company. Mr. Grace would customarily tell Mr. Murphy for whose benefit he desired to create a trust and the assets that he desired to transfer to the trust. Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, would prepare the necessary papers to effectuate Mr. Grace's wishes, and Mr. Grace would sign them.

34. (e) At the time involved in the present litigation, both W. R. Grace and Company and the Grace National Bank were controlled by the Grace family,

of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same building in New York City. Joseph P. Grace maintained his office in the same building.

(b) The Legal Department of W. R. Grace and Company provided legal services not only for that company but also for the Grace National Bank.

(c) The "securities cage" of the Grace National Bank handled the physical delivery and receipt of securities for the bank and for W. R. Grace and Company.

35. J. Morden Murphy was head of the Customers Securities Department of W. R. Grace and Company throughout the period 1930–1931. It was the principal function of that department to manage the securities and real estate of members of the Grace family, most of whom lived in the United States but some of whom lived in England. A great many trusts had been created for various members of the Grace family, and such trusts, together with the securities and real estate in them, were managed by the Customers Securities Department.

36. Alan Ross was employed in the Trust Department of the Grace National Bank throughout the period 1930–1931, and he became head of that department sometime during such period. The Trust Department of the bank did not have any connection with the trusts established for the benefit of members of the Grace family, or with any other aspects of the Grace family's affairs.

37. (a) Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional

activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. If only one spouse in a husband-and-wife relationship was wealthy, it was part of Mr. Ross' plan that the wealthy spouse could transfer property directly to the other spouse, and the husband and wife could then create trusts for the benefit of each other in the manner previously mentioned.

(b) Mr. Ross pointed out to prospective customers that his plan could be utilized for the purpose of equalizing the family income between a husband and wife, and thus effecting annual savings in income taxes.

(c) Mr. Ross also expressed the view to prospective customers that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

38. Alan Ross' plan for husbands and wives in wealthy families to create trusts for the benefit of each other as a means of equalizing income and effecting annual savings in income taxes, and also of ultimately effecting savings in estate taxes if proper precautions were taken in timing the creation of the trusts, was known to, and discussed among, personnel of the Customers Securities Department of W. R.

Grace and Company (J. Morden Murphy and his assistant, Allen S. Rupley) and of the Legal Department of W. R. Grace and Company (Howard N. Deyo, Andrew B. Shea, and a Mr. Cogswell). Howard N. Deyo, head of the Legal Department, did not regard the plan as a sound device for minimizing taxes.

39. (a) Alan Ross suggested to Harold J. Roig that the latter and his wife execute trusts for the benefit of each other. Mr. Roig was an attorney and formerly had been head of the Legal Department of W. R. Grace and Company. In 1930–1931, Mr. Roig occupied an executive position in W. R. Grace and Company, and he also occupied an intimate and confidential relationship with Joseph P. Grace.

(b) Mr. Roig was not interested in Mr. Ross' plan.

40. Alan Ross endeavored to interest William Russell Grace, a brother of Joseph P. Grace, in Mr. Ross' plan for the creation of trusts by a husband and wife for the benefit of each other. William Russell Grace was not interested in the Ross plan.

41. (a) Sometime during the latter part of 1930, Alan Ross approached D. Stewart Iglehart, president of W. R. Grace and Company, and suggested that it might be advantageous if Mr. Iglehart and his wife were to create trusts for the benefit of each other.

(b) Mr. Ross suggested to Mr. Iglehart that the latter could possibly save some income taxes annually by splitting up his income-producing properties between himself and his wife, and then the two of them creating trusts for the benefit of each other. Mr. Ross also suggested to Mr. Iglehart that such a plan would result in savings on estate taxes if Mr. Iglehart first created a trust for the benefit of his wife and then Mrs. Iglehart waited for a reasonable length of time (Mr. Ross suggested at least a year) before creating a trust for the benefit of Mr. Iglehart, so that it would

not appear that the two trusts were created as part of a single plan to avoid the payment of estate taxes.

(c) Mr. Ross had a number of conferences with Mr. Iglehart, extending over a period of several months, in connection with Mr. Ross' suggestion that Mr. Iglehart and his wife create trusts for the benefit of each other. Mr. Iglehart was interested in the plan, but he had his own ideas concerning certain provisions which the trust instruments should contain. For example, Mr. Iglehart insisted that each trust instrument should contain a provision whereby the life beneficiary would have the power, at will, to withdraw all or any part of the principal of the trust at any time.

(d) As a result of the discussions mentioned in this finding, Mr. Iglehart asked Mr. Ross to draft proposed trust instruments in final form, so that Mr. Iglehart could examine them. A list of the assets that might be included in the two trusts was furnished to Mr. Ross by Mr. Iglehart's secretary, pursuant to instructions from Mr. Iglehart.

(e) In accordance with the authorization from Mr. Iglehart, Mr. Ross prepared final drafts of proposed trust instruments whereby Mr. Iglehart and his wife could create trusts for the benefit of each other. Mr. Ross then submitted the proposed trust instruments to Mr. Iglehart for consideration.

(f) A few days later, Mr. Ross found on his desk the two trust instruments that he had submitted to Mr. Iglehart. The document drafted by Mr. Ross for the creation of a trust by Mr. Iglehart for the benefit of his wife had been signed by Mr. Iglehart on February 9, 1931; and the document drafted by Mr. Ross for the creation of a trust by Mrs. Iglehart for the benefit of her husband had been signed on the same date, i.e., February 9, 1931. The execution of the two trust instruments on the same date was not in

accordance with the recommendation as to timing that Mr. Ross had previously made to Mr. Iglehart if savings in estate taxes were to be an objective.

42. D. Stewart Igelhart and Joseph P. Grace had been college classmates, and they were close personal friends. Mr. Grace had brought Mr. Iglehart into the Grace organization. In 1930–1931, Mr. Ilgehart was president of W. R. Grace and Company, and Joseph P. Grace was chairman of the board of that company.

43. Alan Ross never discussed the creation of trusts, or business matters of any kind, with Joseph P. Grace. Mr. Ross never met Janet Grace.

44. In some manner that is not shown by the evidence, Joseph P. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Sometime in 1931, Mr. Grace asked Harold J. Roig what he thought of Mr. Ross' idea respecting such trusts. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating, in effect, that he had not done any legal research on the question, but that it was his "curbstone" opinion that Mr. Ross' plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

45. (a) With respect to the creation of the Joseph Grace trust of December 15, 1931 and the Janet Grace trust of December 30, 1931 (see findings 10, 11, and 12) there had been no prior consultation concerning any such plan by Mr. Grace with J. Morden Murphy when Mr. Grace, in early December of 1931, informed Mr. Murphy that he (Mr. Grace) wanted to have some trusts created by himself and Mrs.

Grace, and that Mr. Murphy should obtain and furnish to Mr. Grace the respective balance sheets of Mr. and Mrs. Grace, showing the assets held at the time by each of them, so that Mr. Grace might select the assets that were to be transferred to the respective trusts.

(b) Mr. Murphy obtained and furnished the two balance sheets to Mr. Grace. Mr. Grace examined the balance sheets, went down each list of assets, and selected the properties that were to be put into the two trusts.

(c) Mr. Grace indicated to Mr. Murphy that he wanted to put into the Joseph Grace trust all the properties of value which he still had and which were of such a nature that they would be suitable to be put in a trust for the lifetime of Mrs. Grace and then go to their children after Mrs. Grace's death.

(d) In connection with the creation of the Janet Grace trust, Mr. Grace selected Tullaroan, the family estate, to be put into that trust, and he also selected 40 shares of stock in the Lundy's Lane Corporation, indicating that the trust should have sufficient income-producing property to defray the taxes on Tullaroan.

(e) Mr. Grace did not make any statement to Mr. Murphy—or to anyone else, according to the evidence in the record—concerning the reason or reasons for the creation of the two trusts, although he indicated that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly in December 1931 because it was his view that a gift tax was "coming along any day now."

(f) It had previously been Mr. Grace's custom, in connection with the creation of trusts for the benefit of his children, to have Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, draft the necessary instruments to accom-

plish Mr. Grace's instructions. In connection with the creation of the Joseph Grace and the Janet Grace trusts of December 1931, however, Mr. Grace had in his possession, on the occasion of his first conference with Mr. Murphy, a draft of a trust instrument (or possibly drafts of two such instruments), which Mr. Grace gave to Mr. Murphy. Mr. Grace indicated to Mr. Murphy that the draft was to be used as a model in preparing the final versions of the instruments creating the Joseph Grace trust and the Janet Grace trust of December 1931. The draft was similar in several respects to the instruments creating the Iglehart trusts (see finding 41).

(g) In connection with the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, Mr. Grace did not indicate any desire to equalize the values of the properties that were to be put in the respective trusts. As a matter of fact, there was considerable uncertainty at the time concerning the true market values of the various properties that were transferred to the respective trusts. This was especially true with respect to Tullaroan, the family estate that was placed in the Janet Grace trust, and the pieces of real estate that were placed in the Joseph Grace trust. It was finally decided that, for the purpose of setting up books of account for the two trusts, approximate values would be assigned to Tullaroan and to the pieces of real estate that were put in the Joseph Grace trust, as it seemed unnecessary to make the considerable effort that would have been required to obtain accurate appraisals.

(h) After Joseph P. Grace had selected the various properties that were to be transferred to the Joseph Grace trust and the Janet Grace trust of December 1931, the final drafts of the documents creating those trusts were prepared in the Legal Department of

W. R. Grace and Company. It is inferred that this assignment was relayed to the Legal Department by J. Morden Murphy. The final drafts were modeled on the earlier draft which Mr. Grace had given to Mr. Murphy on the occasion of their first conference concerning the creation of the trusts, although certain changes were made by the Legal Department.

46. (a) During the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace concerning the includibility of certain property items in the estate tax return of the estate of Janet Grace (see finding 21), Joseph P. Grace attended a conference with Oscar M. Bate and Robert L. Loeb. Messrs. Bate and Loeb were members of the law firm of McFarlane & Munroe, which was representing the estate of Janet Grace and which also acted as counsel to Joseph P. Grace from time to time with respect to legal matters which Mr. Grace believed to be beyond the competency of the Legal Department of W. R. Grace and Company. At the conference, Mr. Bate, who was senior to Mr. Loeb in their law firm, informed Mr. Grace that the Internal Revenue Service was taking the position that the trusts created by Mr. Grace and his wife in December 1931 was reciprocal trusts and that, under fairly recent court decisions, one of the trusts was includable in the estate tax return of Janet Grace. Mr. Bate advised Mr. Grace that if the trusts were set up in consideration of each other, the law firm felt that one of the trusts was includable in the estate tax return of Janet Grace, but the firm did not know which one. Mr. Bate further stated that he thought the Internal Revenue Service could probably be persuaded to accept the view that the trust created by Mrs. Grace was the one taxable against her estate, and that this would be advantageous because, at the time of Mrs. Grace's death,

the assets in the Janet Grace trust had a considerably smaller value than the assets in the trust created by Mr. Grace.

(b) Mr. Grace, in effect, told Mr. Bate to go ahead and make the best settlement with the Internal Revenue Service that he could.

(c) Mr. Grace, at the conference, did not deny the reported contention by the Internal Revenue Service that the Joseph Grace trust and the Janet Grace trust of December 1931 were created in consideration of each other.

(d) As the result of the negotiations between the Internal Revenue Service and the estate of Janet Grace, a compromise agreement was entered into whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned the counter-contentions which the estate had asserted during the course of the negotiations, to the effect that certain shares of stock had been over-valued in the estate tax return and that certain household effects previously included in the estate tax return should be eliminated from it.

47. Following the payment of the deficiency and interest in the total amount of $419,221.05 by the estate of Joseph P. Grace on July 14, 1954 (see finding 24), Michael P. Grace, II, one of the sons of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, proposed to Joseph Peter Grace, Jr., and Charles MacDonald Grace, his two brothers and fellow executors, that a claim for refund be filed by the estate of Joseph P. Grace with the Internal Revenue Service.

48. (a) On June 27, 1956, Joseph Peter Grace, Jr., a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, conferred with his

attorney, Judge Burns, of the law firm of Burns, Currie, Maloney & Rice, with Francis Currie, a partner of Judge Burns, with Allen S. Rupley, who was then an official of W. R. Grace and Company, with Mr. Cogswell, of the Legal Department of W. R. Grace and Company, with Mr. Ray, who was then the senior trust officer of the Grace National Bank (the bank being part of the committee for Janet Maureen Grace), and with Robert L. Loeb, counsel for the estate of Janet Grace. The purpose of the conference was to determine whether Joseph Peter Grace, Jr., should join with Michael P. Grace, II, in filing a claim for refund on behalf of the estate of Joseph P. Grace.

(b) Francis Currie had previously conducted an investigation among personnel of W. R. Grace and Company and of the Grace National Bank in an effort to develop as much information as possible concerning the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, and Mr. Currie disclosed to the conferees on June 27, 1956 the results of his investigation.

(c) Robert L. Loeb informed the conferees on June 27, 1956 concerning the conference that he had attended with Joseph P. Grace during the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace (see finding 46). Mr. Loeb said to the conferees on June 27, 1956 that he thought Joseph P. Grace, at the earlier conference, recognized that the two trusts were factually reciprocal, that Mr. Grace did not wish to litigate the issue, and that Mr. Grace wanted to make a settlement.

(d) On the basis of the discussion at the conference on June 27, 1956, Joseph Peter Grace, Jr., instructed his attorney not to join in a claim for refund.

49. (a) On July 9, 1956, Charles MacDonald Grace, a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, attended a conference with his attorney, Judge Burns, with Francis Currie, and with Mr. McDevitt. The other conferees informed Charles MacDonald Grace of the decision previously made by Joseph Peter Grace, Jr., not to join in a claim for refund (see finding 481), and they advised Charles MacDonald Grace that he should also decline to join in such a claim.

(b) In accordance with the advice received by him, Charles MacDonald Grace said at the conference on July 9, 1956 that he would not join in a claim for refund.

50. On August 2, 1956, Francis Currie wrote a letter to Morris W. Primoff, attorney for Michael P. Grace, II, and stated in part as follows:

> I am authorized to say that Messrs. Peter and Charles Grace are completely satisfied that the available evidence will not sustain the burden of proof to support the claims for refund filed by Mr. Michael Grace. On the contrary, all available evidence indicates that the trusts in question were specifically intended to be reciprocal, in order to avoid gift taxes which became effective on January 1, 1932, and to avoid estate taxes through a method generally regarded as available prior to the decision in the Lehman case. In the light of this evidence of which they are aware, Messrs. Peter and Charles Grace cannot join in the claims for refund filed by Mr. Michael Grace.
>
> Messrs. Peter and Charles Grace have reached this conclusion reluctantly, in view of their personal interests in any refund which might be recovered. The share of Mr. Charles Grace in the amount of federal estate tax and interest which might be recovered if the claim for refund were allowed would be almost $40,-

000; the share of Mr. Peter Grace would be over $235,000, considerably larger than the share of Mr. Michael Grace.

I am also authorized to say that Grace National Bank of New York, as a member of the Committee for the Property of Janet Maureen Grace, concurs in the decision of Messrs. Peter and Charles Grace not to join in the claim for refund.'

51. (a) The original petition in the present action was filed on September 24, 1959 by Michael P. Grace, II, as an executor of the estate of Joseph P. Grace, deceased.

(b) After the filing of the original petition, the attorney for Michael P. Grace, II, represented to Joseph Peter Grace, Jr., and Charles MacDonald Grace that the claim asserted in the petition might be denied by the court on the ground of defective parties plaintiff. At the request of the attorney for Michael P. Grace, II, and because Joseph Peter Grace, Jr., and Charles MacDonald Grace did not wish to forfeit any money that they might be entitled to receive, Joseph Peter Grace, Jr., and Charles MacDonald Grace decided to join in the prosecution of the case before the Court of Claims.

(c) On August 2, 1963, the first amended petition was filed in the present action by the estate of Joseph P. Grace, deceased, and by Michael P. Grace, II, Joseph Peter Grace, Jr., and Charles MacDonald Grace, executors.

52. The evidence in the record does not indicate that Joseph P. Grace was motivated by the desire to avoid or lessen estate taxes in the setting up of the Joseph Grace trust and the Janet Grace trust in December 1931.

53a. The Joseph Grace trust and the Janet Grace trust were created by, or at the instigation of, Joseph

P. Grace as parts of what was essentially a single transaction.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover, and judgment is entered to that effect. The amount of recovery will be determined pursuant to Rule 47(c)..

(Title omitted in printing)

ORDER

This case comes before the court on its own motion to amend the caption set forth on and in the order entered herein on June 28, 1968. Upon consideration thereof

IT IS ORDERED that the part of the caption in the order of June 28, 1968, designating the plaintiffs as "ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL" be and the same is stricken and deleted and in lieu thereof shall be inserted as plaintiffs the caption "ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS."

By the Court:

———— ————,
Chief Judge.

Dated: JULY 3, 1968.

(Title omitted in printing)

ORDER

On April 19, 1968, the court rendered an opinion holding that the plaintiffs were entitled to recover and entering judgment to that effect. The determination of the amount of the recovery was reserved pending further proceedings pursuant to Rule 47(c).

On June 24, 1968, the commissioner of this court filed a memorandum report recommending that, in accordance with the opinion of the court and the stipulation of the parties, judgment be entered for the plaintiffs in the sum of $419,221.05, together with interest thereon from July 14, 1954, as provided by law, which recommendation is adopted by the court.

It Is Therefore Ordered that judgment be and the same is entered for the plaintiffs in the sum of four hundred nineteen thousand two hundred twenty-one dollars and five cents ($419,221.05), together with interest thereon from July 14, 1954, as provided by law.

By the Court:

__________,
Chief Judge.

Dated: June 28, 1968.

ORDER ALLOWING CERTIORARI

Filed December 9, 1968.

The petition herein for a writ of certiorari to the United States Court of Claims is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U.S. GOVERNMENT PRINTING OFFICE: 1969

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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. ——

UNITED STATES, PETITIONER

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

OPINION BELOW

The majority and dissenting opinions and the findings of fact of the Court of Claims (Appendix, *infra,* pp. 1a–68a) are reported at 393 F. 2d 939.

JURISDICTION

The judgment of the Court of Claims was entered on June 28, 1968, and amended in a nonmaterial respect on July 3, 1968. (Appendix, *infra,* pp. 69a–70a.) The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Where, as parts of a single transaction planned by the decedent-husband, he and his wife each transferred separately owned property under substantially identical trust instruments, naming each other as life beneficiary and their children as remaindermen, whether the value of the property transferred by the wife for the lifetime benefit of the decedent-husband should be offset against the value of the property transferred by him for her lifetime benefit, and hence included in his gross estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939 as a transfer of property with a retained life estate.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property

*   *   *   *   *

(c) * * * (1) GENERAL RULE.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

*   *   *   *   *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right,

either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom;

* * * * *

STATEMENT

Joseph P. Grace,[1] a man of considerable wealth, died in July 1950 at the age of 73 (Findings 22; App. 52a). At the time of their marriage in 1908, his wife, Janet Grace, had no wealth or property of her own (Findings 2, 4; App. 32a, 33a). Between then and 1931 decedent made a number of transfers of property to his wife, including the 167-acre estate, Tullaroan, where they lived, and securities and real estate having a cost of almost $2,000,000 (Findings 6, 7, App. 34a, 35a). Janet had no interest in and took no part in business matters. Decedent made all the financial decisions and had her execute such instruments with respect to her property as were appropriate (Finding 5(a); App. 33a).

In December 1931, decedent had prepared for his own and for his wife's signature two virtually identical trust instruments providing for transfer of certain of his property in trust for Janet for life and transfer of certain of her property in trust for himself for life, with the remainders under both trusts to their children. For the Joseph P. Grace (transferor) trust he selected all investment properties of value that he still had and deemed suitable for the corpus of such a trust. For the Janet Grace (transferor) trust, he selected Tullaroan and shares of stock in a personal

[1] Hereinafter referred to as the decedent.

holding company, which held Janet's investments. (Findings 10, 11(b)–(h), 12(b), 12(d), 45(c) and (d); App. 37a, 39a–43a, 45a–47a, 61a.)

For each trust he chose three trustees, two of whom were his brother and his nephew and the third of whom was the respective transferor. In both trusts decedent alone retained the power to direct the sale, investment and reinvestment of all property, including Tullaroan. Each life beneficiary was entitled to the entire net income and to any of the principal, including the whole, which a majority of the trustees decided to convey to him or her.[2] Decedent was also entitled to use and occupy Tullaroan. Decedent executed his trust instrument on December 15, 1931, and caused Janet to execute hers on December 30, 1931. During their respective lifetimes,[3] Janet had $133,627 in income from the Joseph Grace trust, and decedent received $389,465 in income from the Janet Grace trust. (Findings 11(a), 12(a), 12(c), 20, 23, App. 37a–39a, 43a–45a, 46a, 50a 52a.)

After decedent's death in July 1950, the Internal Revenue Service determined that the two transfers

[2] In April 1932 decedent and his fellow trustees of the Joseph Grace trust, gave over to Janet securities having a book value of $173,434. She simultaneously turned the securities over to decedent. (Findings 11(e), 17, 20(c); App. 41a, 49a, 50a.)

[3] After Janet's death in December 1937 the Treasury ruled that the two trusts were reciprocal, and that the trust which had the lesser value was includible in her estate. Both parties agreed that the Janet Grace trust had the lesser value, and it was appraised at her death at $612,334. Mutually offsetting contentions with respect to this and other issues resulted in a compromise adding $336,783 to the gross estate. (Findings 21, 46 App. 50a, 63a.)

in trust had been reciprocal and added to the value of the gross estate reported in his estate tax return $1,116,888, the value at decedent's death of the corpus of the Janet Grace trust. A tax deficiency of $419,221, including interest, was assessed and paid, and this timely refund suit was brought (Findings 24, 25; App. 52a, 53a).

The Court of Claims, two judges dissenting, held that Section 811(c)(1)(B) of the Internal Revenue Code of 1939 (pp. 2-3, *supra*) would require inclusion of the Janet Grace trust in decedent's estate only if he (App. 5a), in establishing the Joseph Grace trust, "was furnishing consideration for—i.e. * * * he was paying for—the subsequent creation of the Janet Grace trust * * *. This * * * involves an inquiry into the element of motivation." After reviewing the evidence, the court concluded that there was no intent to furnish consideration for, or pay for, the Janet Grace trust because (App. 13a) "neither the decedent nor Janet Grace had any desire to acquire property from the other." While the majority said that decedent (App. 19a and Finding 45e; App. 61a) "was not motivated by a purpose to minimize taxes of any kind," it also said that the purpose of the trusts he and his wife established for each other's benefit was to transfer property among family members (App. 13a) "with a minimum of gift-tax consequences." Conversely, it reasoned there was no basis in the record for a finding that Janet Grace, in making her transfer, was influenced by the circumstance that the decedent had previously created his own trust—"[o]n the basis of the whole record, it is reasonable to infer that Janet

Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so." (App. 15a).

The court also stated that the result would be the same if the question of "consideration" was tested by the "objective" evidence, because decedent "never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust * * * and caused his wife to create the Janet Grace trust" in 1931. (App. 16a.)

The dissenting judges were of the opinion that even under the majority's view of the applicable legal principles, the evidence indicated that (App. 21a) "in common sense * * * one of these inter-related trusts was in exchange for the other * * *". They argued (App. 25a), moreover, that the majority had applied erroneous principles: "[T]he correct question—once the cross-trusts are seen as inter-dependent (as has been found here)—is whether the trust created by the two settlors put both in approximately the same economic position, objectively, as they would have been in if each had created its own trust * * *." Because the transfers here left decedent (App. 30a) "up to the limits of his wife's trust, in the same position as if he had given himself, rather than his wife, the life interest under the Joseph trust," the dissenters thought the Jane Grace trust should be included in decedent's estate.

REASONS FOR GRANTING THE WRIT

The federal estate tax has long required that a decedent's gross estate include the value of any property he transferred during his lifetime, if "he has retained for his life * * * the possession or enjoyment of, or the right to the income from the property".[4] Here the decedent and his wife each created a trust (Finding 53a; App. 67a–68a) "as parts of what was essentially a single transaction," each naming the other as life beneficiary and their children as remaindermen. In holding that the reciprocal gifts by and between the donor-donee spouses were to be viewed as if they were separate and independent gifts to third party donees, the Court of Claims ignored the fundamental rule, repeatedly reaffirmed by this Court, that tax consequences flow from the economic substance and effect of a transaction and not its form. Its decision is squarely at odds with a long line of decisions by the courts of appeals—decisions which, in 1949, received express Congressional endorsement. If permitted to stand, the decision will re-open an estate tax loophole hitherto deemed effectively closed, and invite renewed attempts by wealthy couples to deplete their taxable estates without effecting any material change in their economic positions while they live.

1. Cases in the Second, Seventh, Eighth, and Ninth Circuits are in conflict with the decision here. The thrust of another line of cases—all in the Third Circuit—is unclear, although it appears that that court

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[4] *E.g.*, Section 811(c) of the Internal Revenue Code of 1939; Section 2036(a) of the Internal Revenue Code of 1954.

too might have ruled in favor of the taxpayers in this case.

The first decision, and the one that other courts have treated as the seminal authority, was *Lehman* v. *Commissioner*, 109 F.2d 99 (C.A. 2) (opinion by Patterson, J.), certiorari denied, 310 U.S. 637. There the decedent and his brother each had created in 1930 a trust for the other's benefit for life, with remainder to the life tenant's issue, and each brother gave the other the right to withdraw $150,000 from the principal of the trust for his benefit.

Although the decedent died without exercising his right to the $150,000, the Second Circuit, affirming the Tax Court, included the sum in his gross estate as an interest "of which the decedent has at any time made a transfer * * * where the enjoyment thereof was subject at the date of his death to * * * a power * * * to * * * revoke." Section 302(d) of the Internal Revenue Act of 1926, c. 27, 44 Stat. 9 (Similar to 1939 Code Section 811(d) and 1954 Code Section 2038).[5]

The court thought the situation (109 F.2d at 100) "in substance the same" as though "the decedent had transferred his share of the property to trustees for his own use for life * * *." The court reasoned (*ibid.*):

[5] Only the $150,000—and not the remainder of the corpus—was placed in the estate because the then prevailing case law held that transfers of property reserving life estates, made prior to the Joint Resolution of March 3, 1931, c. 454. 46 Stat. 1516, were not includible in the gross estate. See 109 F.2d at 101. However, this Court held in *Commissioner* v. *Estate of Church*, 335 U.S. 632, that the entire corpus is includible in such circumstances, even if the transfer occurred before 1931.

"the fact that the trusts were reciprocated or 'crossed' is a trifle, quite lacking in practical or legal significance. * * * The law searches out the reality and is not concerned with the form."

In addition, the Second Circuit said (*ibid.*):

> The outcome would be the same if the decedent had transferred his share outright to his brother. The decisive point is that the decedent * * * caused the brother to make a transfer of property in trust under which the decedent had the right to withdraw $150,000 from principal * * *. "A person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another." Scott on Trusts, section 156.3.

The Second Circuit reaffirmed *Lehman* in *Hanauer's Estate* v. *Commissioner,* 149 F.2d 857, certiorari denied, 326 U.S. 770 and *Orvis* v. *Higgins,* 180 F.2d 537, certiorari denied, 340 U.S. 810. Those were cases, such as the present one, where a husband and wife each created a trust for the other's lifetime benefit. In *Hanauer* the court affirmed a Tax Court decision that the failure to execute the trusts (149 F.2d at 858) "independently and apart" showed that each trust was established "in consideration of the other." Because the wife customarily relied on the judgment of "the business men of the family", and had allowed her husband and son-in-law to select the properties for his trust, the trusts were contemperaneously (*id.* at 859) "developed and executed as though all part of a single transaction". The court of appeals therefore held the finding "justified" and the husband's

"motive * * * not controlling." And in *Orvis* the court reversed a trial court finding for the taxpayers, holding that (180 F.2d at 540) "negative testimony as to the absence of an expressed intention to act reciprocally" failed to overcome the inference of reciprocity inherent in the fact that the two trusts were conceived of and established at about the same time.

In *Cole's Estate* v. *Commissioner*, 140 F.2d 636 (C.A. 8), the husband, in 1931, had transferred 700 shares of stock in trust for his wife for life with remainder to their children and grandchildren, and on the same day the wife had transferred 300 shares in trust for the husband for life and the same remaindermen. Both the husband and wife died during 1939. The Eighth Circuit, affirming the Tax Court, held that 300 shares should be included in each estate. In rejecting the taxpayers' argument that the Tax Court's decision in favor of the government was fatally defective because there was (140 F.2d at 637) "no finding that one trust was made in consideration of the other," the court concluded that the situation was "the same as if one decedent had 'exchanged' 300 of his shares for 300 shares of the other. * * * [I]n an exchange the property received is consideration for the property given." The court then went further, and said that even in the absence of the "exchange", the reciprocal trusts would not have operated to exclude the stock from the estate tax because (*id.* at 638): "To the extent of the income from 300 shares of the stock there was no change in the economic position of either grantor." The Eighth Circuit, like the Second, has reiterated and

adhered to its positions in subsequent cases. See *Guenzel's Estate* v. *Commissioner*, 258 F.2d 248, 254; *Moreno's Estate* v. *Commissioner*, 260 F.2d 389.

The Seventh Circuit has twice followed the lead of the Second and Eighth. *Olson* v. *Reisimer*, 271 F.2d 623, and *Glaser* v. *United States*, 306 F.2d 57.[6] And the Ninth Circuit, in a case growing out of a round robin of trusts established by three brothers, each for the benefit of one of the others, relied on *Lehman* in holding that the beneficiary of each trust should be treated as the settlor for gift tax purposes. *Commissioner* v. *Warner*, 127 F.2d 913.

Congress recognized and approved cases such as *Lehman* and *Cole's Estate* in enacting the Technical Changes Act of 1949, c. 720, 36 Stat. 891. Section 6 added Section 1000(g) to the 1939 Code, which per-

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[6] Compare, however, *McLain* v. *Jarecki*, 232 F.2d 211, where the Seventh Circuit affirmed a trial court decision declining to find reciprocity in trusts created by husband and wife, each providing that the other was to receive the trust income after the settlor's death. The court based its decision on a conclusion that none of the stipulated facts expressly showed that the husband "brought about the transfer from his wife * * *." (*id.* at 211) In *Glaser* v. *United States*, *supra*, though, in an indistinguishable situation, the same court reversed a district court finding that there was no reciprocity in a transaction where a husband and wife conveyed land to their daughter and son-in-law at the same time as the latter conveyed land to the parents for life with the remainder to another child. Without referring to its earlier decision in *McLain* the court ruled that (306 F.2d at 61) "looking through form to substance, however, decedent and his wife merely substituted one piece of property for another of equal value." Consequently we assume that *Glaser* and *Olson*—and not *McLain*—represent the rule that now applies in the Seventh Circuit.

mitted grantors of reciprocal trusts created prior to 1940 (when *Lehman* was decided), but not those created thereafter, a limited time in which to relinquish the power they received over the property or income, without incurring additional gift tax if they had originally paid gift tax on their own transfers. The Senate Committee report described the *Lehman* line of decisions as "present law" requiring "nominal grantors [of reciprocal trusts] to be interchanged for [estate] tax purposes," and it expressed particular approval of the *Lehman* rule as overcoming a popular device used by husbands and wives who thought they "could transfer property to their heirs without diminishing effective control during life but still paying the gift tax rather than the estate tax." S. Rep. No. 831, 81st Cong., 1st Sess., pp. 5–6.

The Third Circuit, on the other hand, has taken a different and somewhat confusing view of the appropriate rule. In the first case presenting the problem, that court, in a *per curiam* opinion, affirmed a decision of the Tax Court which had followed *Lehman* and *Cole's Estate*. See *Estate of Oliver* v. *Commissioner*, 148 F. 2d 210, affirming decision of April 28, 1944 (P-H Memo T.C. ¶ 44,138). Then, however, in *Lueders' Estate*, 164 F. 2d 128, that court reversed a similar Tax Court decision. There a husband and wife, 15 months apart, had each created a trust for the life benefit of the other. The Third Circuit concluded that the evidence did not support a finding that one spouse had provided consideration for the other's transfer, and in doing so, ruled that consideration in this context means the same as it does in the

law of contracts. Under that analysis, there must be an (*id.* at 135) "act * * * or the promise to act * * * simultaneously with" the establishment of the trust—even "concerted action" in establishing the trusts would otherwise be insufficient.

Although this decision, by itself, could be construed as resting on the 15 months interval between the execution of the two trusts, see 164 F. 2d at 135, the ~~Third Circuit~~ reached the same result in *Myrtle H. Newberry's Estate* v. *Commissioner*, 201 F. 2d 874, a case involving the simultaneous execution of trusts by husband and wife, for the benefit of their children, each giving the other full power to amend and to shift interests among their issues and charity. The court said (*id.* at 877):

> Actually, some of the cases seem to go rather far in inferring such payment or consideration in connection with reciprocal or crossed provisions. But this court in In re Leuders' Estate * * * has taken the lead in indicating that payment for the creation of a trust by another must be real if the alleged payor rather than the apparent settlor is to be treated as grantor of the trust. The essential picture which the crossed trust must reveal to justify the result reached by the Tax Court in the present case is a declared grantor *induced* to establish a trust giving the party now to be treated for tax purposes as the grantor, a power which the latter *has wanted* and has paid for by setting up another trust to accomplish something *desired* by the declared grantor. Such in our view are the rather strict confines of the Lehman Doctrine. [Emphasis supplied.]

In the interval between the decisions in *Leuders' Estate* and *Newberry's Estate,* the court in *Estate of Carrie S. Newberry* v. *Commissioner,* 172 F. 2d 220, affirming decision of April 30, 1947 (P-H Memo T.C. ¶ 47,113), affirmed *per curiam* another decision of the Tax Court which relied on the *Lehman* and *Cole's Estate* cases.

These decisions in the Third Circuit are confusing, but it would appear that the Third Circuit, like the Court of Claims, would invoke the reciprocal trust doctrine only in cases where one party has a subjective desire to secure the other's property in exchange for his own.

2. *Lehman, Cole's Estate,* and the similar cases correctly interpret Section 811(c)(1) of the 1939 Code and its successor, Section 2036 of the Internal Revenue Code. The decision below, as well as the similar results in the Third Circuit, evince a mistaken view of the statute and unnecessarily open the way to frustration of the legislative objective.

Section 811(c)(1) and Section 2036(a) of the 1954 Code require that a decedent's estate include, for federal tax purposes, the "value" of any interest of which he "at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * the possession or enjoyment of, or the right to the income from, the property * * *." This requirement is one of several, incorporated in sub-sections of Section 811 of the 1939 Code and in Sections 2035 through 2038 of the 1954 Code, which require that a gross estate include the value of property that the decedent transferred while he was alive, but

retaining an economic interest in or control over the property.

With one exception—the section dealing with transfers in contemplation of death[7]—these provisions all deal with the net economic effect of a decedent's actions. The idea is to allow the value of property to escape the estate tax if the decedent completely parted with it during life, but to include such value in the gross estate if the decedent retained some significant interest in it. In the application of these parts of the Code, economic realities have always superceded subjective questions of the decedent's motive. As this Court said with respect to transfers "intended to take effect in possession or enjoyment at or after [decedent's] death"[8] (*Estate of Spiegel* v. *Commissioner*, 335 U.S. 701, 705-706): "Any requirement * * * such as a post-death attempt to prove the settler's thought in regard to the transfer, would impair the effectiveness of the 'possession or enjoyment' provisions as an instrument to frustrate tax evasions." See, also, *Commissioner* v. *Estate of Church*, 335 U.S. 632, 638.

This rationale provides the underpinning of *Lehman* and its progeny. As the Eighth Circuit said in *Cole's Estate* v. *Commissioner, supra*, 140 F. 2d at 638:

> * * * as a result of the terms of the identical and simultaneous trusts and of "the familial relationship", each decedent "retained the sub-

[7] Section 811(c)(1)(A) of the 1939 Code; Section 2035 of the 1954 Code.

[8] Section 811(c)(1)(C) of the 1939 Code; Section 2037 of the 1954 Code.

stance of full enjoyment of all the rights [for life] which previously he had in the property." *Helvering* v. *Clifford*, 309 U.S. 331, 336.

There are, to be sure, suggestions, to which the Court of Claims pointed here (App. 15a–16a), that the decisions placing reciprocal trusts in the beneficiaries' estates rest on a finding that one trust constituted "consideration" for the other. But the "consideration" referred to is by no means the subjective motivation or the overt evidence of a tax avoidance objective that the Court of Claims majority deemed the touchstone of taxability. Quite to the contrary, the Eighth Circuit made clear in *Cole's Estate* that the consideration in question exists whenever the cross trusts have left the decedent's economic position essentially unchanged. See 140 F. 2d at 637. Nor is there anything in the *Lehman* line of authority to support the Third Circuit's view that there must be an intent to give a *quid* for a *quo*. Rather the Second Circuit has insisted (*Hanauer's Estate* v. *Commissioner*, *supra*, 149 F. 2d at 859) that the decedent's "motive was not controlling", and the Eighth Circuit has said much the same in *Guenzel's Estate* v. *Commissioner*, *supra*, 258 F. 2d at 254. See, also, *Olson v. Reisimer*, *supra*, 271 F. 2d at 626–627, quoting from *Moreno's Estate*, *supra*, 260 F. 2d at 392.

This rule is as it should be. "A 'consideration test' based upon the unknown and unknowable state of mind of the transferors is sheer fiction; it is no test at all." Lowndes, *Consideration and the Federal Estate and Gift Taxes*, 35 Geo. Wash. L. Rev. 50, 80.

Once it is shown that a decedent and one or more other persons each has an interest in, or a power over,

a trust, one of the others created, the overall state of affairs must be measured against the purpose of Section 811 or the parallel provisions of the 1954 Code. The prophylactic objective of the statute may readily be defeated unless the decedent's estate includes the value of the trust of which he is a beneficiary, at least to the extent that it offsets the value of property he transferred for one of the other's benefit, since the result is exactly the same as it would be if the decedent had retained an interest in, or power over, the trust he himself transferred. "[I]t requires no citation of authority for the proposition that in an exchange the property received is consideration for the property given." *Cole's Estate, supra,* 140 F. 2d at 637.

3. Judged by these standards there can be no foundation for a decision in favor of the taxpayers in this case. Here the decedent-husband transferred property in trust for his wife for life with remainder to their children. Two weeks later, under a virtually identical trust, and "acting in accordance with the plan of the decedent" (Finding 12(a); App. 43a–45a; see, also, App. 9a–10a), his wife transferred property in trust for his life with remainder to their children. The two trusts were (Finding 53a; App. 68a) "parts of what was essentially a single transaction," and the husband (App. 16a) "caused his wife" to execute her trust.

Of course, neither decedent nor his wife was prompted by a desire to purchase or obtain the property of the other. But what would be the significance of such a motive? Even applying a test of mutual consideration, a husband—such as the decedent here—who deals with himself as his wife's agent, and takes property from his wife for his own benefit, while giving

his property to her, obviously satisfies mutual obligations by his own acts. More important here, under the series of transfers the decedent devised and had executed, there was no practical change in the family financial condition. As a result of the transfers, the decedent did not part with more than the difference between the value of his transfer to her and her transfer to him. Section 811(c)(1)(B) therefore requires that his estate include what he received just as though he had established the trust for his own benefit.

Nor is it enough, as the Court of Claims held (App. 16a–19a), to await proof of a tax avoidance motive to find adequate evidence of "consideration". Every provision of Section 811 and its counterparts in the 1954 Code—except those involving gifts made in contemplation of death—turns on the nature and on the effect of a given transaction and not on the decedent's motive. They must be applied according to the objective standards Congress determined, whether or not proof of a tax avoidance purpose is available. Cf. *Commissioner* v. *Gordon*, 391 U.S. 83, 90–91 n. 5. And, of course, this is all the more necessary in this case, where motive can only be determined by consideration of what a dead man supposedly said and thought many decades ago.

4. The question presented is an important and recurring one in the administration of the federal estate tax laws. The formulation of the reciprocal trust rule in *Lehman* and *Cole's Estate* had been thought to put to rest a popular device for avoiding estate tax,[9] and

[9] See Colgan and Malloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device*, 3 Tax L. Rev. 271, 273.

this was reflected in the relief provisions enacted by Congress in the Technical Changes Act of 1949, *supra*, applicable only to those setting up such trusts prior to the *Lehman* decision.

The instant decision of the Court of Claims opens renewed prospects of avoiding taxes on substantial estates through resort to reciprocal trusts. A requirement that the test of taxability be the presence of a subjective intent to give "consideration"—even in the case of such prearranged husband and wife crossed-trusts as this case presents—nullifies the concept developed in *Lehman* and *Cole's Estate* in the very circumstance where Congress thought it had its most important application. Wealthy husbands and wives who have ample additional means or who do not covet each other's property could never be deemed to have set up such trusts in order to induce or pay for each other's transfer. The decision will have reopened a glaring loophole in the estate tax law inviting renewed attempts by husbands and wives to deplete the value of their taxable estates while retaining full enjoyment of all their assets, simply by creating cross trusts in favor of each other with remainders to their children. And, so long as the conflict in decisions is not resolved, those able to pay deficiencies and bring refund suits in the Court of Claims—whose jurisdiction is nationwide—will escape taxation; only those who are remitted to deficiency redeterminations in the Tax Court, and do not on appeal have access to the Third Circuit, will be held within the bounds of the decisions that Congress approved some 19 years ago.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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SEPTEMBER 1968.

APPENDIX

ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS ET AL. PLAINTIFFS

v.

U.S., DEFENDANT

U.S. Court of Claims, No. 400–59, April 19, 1968

Before COWEN, Chief Judge, LARAMORE, DURFEE, DAVIS, SKELTON, and NICHOLS, Judges.

OPINION

PER CURIAM:

This case was referred to Trial Commissioner Mastin G. White with directions to make findings of fact and recommendation for conclusions of law. Following a trial on the merits, the commissioner filed an opinion and report, and the case was submitted to the court on the briefs of the parties. After hearing oral argument of counsel, we remanded the case to the commissioner for determination "whether the decedent [Joseph P. Grace] was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid and lessen estate taxes." A further trial was held and thereafter the commissioner filed his supplemental report and a memorandum opinion.

After hearing additional oral argument and considering the briefs and exceptions of the parties, we have determined that the findings of fact made by the commissioner are amply supported by the record and

that where such findings consist of inferences based on circumstantial evidence, the inferences may reasonably be drawn from the record. The court is also in agreement with the opinions of the trial commissioner, as modified and combined into a single opinion, and hereby adopts the same, together with his findings of fact, as the basis for its judgment in this case.[1] Therefore, plaintiffs are entitled to recover and judgment is entered to that effect with the amount of recovery to be determined pursuant to Rule 47(c).

Commissioner White's opinions, as modified and unified by the court, are as follows:

The primary question to be decided in this case is whether the Internal Revenue Service acted correctly in adding to the gross estate of Joseph P. Grace, who died on July 15, 1950, the sum of $1,116,-888.62, representing the value of a trust that had been created on December 30, 1931.

The Internal Revenue Service purported to act under the authority of Section 811(c) of the Internal Revenue Code of 1939, as amended.[2] That section, at the time of the decedent's death, provided (among other things) that the value of the gross estate of a decedent should be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, "To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * the possession or enjoyment of, or the right to the income from, the property * * *."

[1] The dissenting opinion of Davis, Judge, in which Nichols, Judge, concurs follows the opinion of the Trial Commissioner which has been adopted by the court.

[2] When the decedent died on July 15, 1950, the original language of Section 811(c), as found in 53 Stat. at pp. 120–121, had been amended by Section 7(a) of the Act of October 25, 1949 (63 Stat. 891, 894).

It is clear that under the provisions of the trust of December 30, 1931, the decedent for his lifetime had the right to the income from the income-producing portion of the trust property, and that he was entitled to the possession and enjoyment of the remainder of the trust property. On the other hand, the decedent, at least in form, was not the settlor of the trust, he had not directly "made a transfer" of any property or interest in property to the trust, and, strictly speaking he had not "retained" any beneficial interest in the trust property but, rather, had obtained such interest by virtue of the instrument creating the trust The person who executed the instrument creating the trust of December 30, 1931, and who directly transferred to that trust all the property covered by it, was the decedent's wife, Janet Grace. (For the sake of convenience, the trust of December 30, 1931, will usually be referred to hereafter in the opinion as "the Janet Grace trust.")

The defendant contends that the decedent, by himself creating on December 15, 1931, a reciprocal trust which conferred on Janet Grace benefits similar to those which were conferred on the decedent by the Janet Grace trust, furnished consideration for the creation of the Janet Grace trust; and, therefore, that for estate-tax purposes the decedent and Janet Grace should be switched or crossed as settlors and the decedent should be regarded as having been in substance the settlor of the Janet Grace trust. This contention is based upon a judicially developed rule that was first announced in the case of *Lehman* v. *Comm'r,* 109 F. 2d 99 (2d Cir. 1940), cert. denied 310 U.S. 637.

The facts in the *Lehman* case were stipulated by the parties. According to the stipulation, two brothers, Harold M. and Allan S. Lehman, owned equal shares

in certain stocks and bonds. Harold agreed to transfer his share in trust for Allan and the latter's issue, in consideration of Allan transferring his share in trust for Harold and Harold's issue, and trusts were created in accordance with the agreement. The income from the trust property transferred by Harold was to be paid to Allan for his life, with the remainder to Allan's issue, and Allan had the right to withdraw not to exceed $150,000 of the principal. Similarly, the income from the trust property transferred by Allan was to be paid to Harold for his life, with the remainder to Harold's issue, and Harold had the right to withdraw up to $150,000 of the principal. Harold later died, and the court was called upon to decide whether trust property transferred by Allan was taxable as part of Harold's estate. This question was answered in the affirmative. The court said (109 F. 2d at pp. 100–101) that Harold, by transferring his share of the stocks and bonds in trust for the benefit of Allan and the latter's issue, had "paid for and brought about" the transfer by Allan of his share of the stocks and bonds in trust for the benefit of Harold and Harold's issue; and, therefore, that Allan's transfer was in substance a transfer by Harold, so as to make the property so transferred part of Harold's taxable estate.

There are two divergent views of the precise proposition that the *Lehman* case stands for, each espoused in several cases. Since, in this case the same result is reached under either view, we have not felt it necessary to choose between the two lines of cases. Each shall be considered in turn.

According to one line of cases, the crucial factor in the *Lehman* case was that, under the agreed facts, Harold Lehman had furnished consideration for—i.e., he had "paid for and brought about" the transfer of

property by Allan Lehman in trust for the benefit of Harold Lehman and the latter's issue. *In re Lueders' Estate,* 164 F. 2d 128, 133–4 (3d Cir. 1947); *Newberry's Estate* v. *Comm'r,* 201 F. 2d 874, 877 (3d Cir. 1953); *McLain* v. *Jarecki,* 232 F. 2d 211, 213 (7th Cir. 1956); *Tobin* v. *Comm'r,* 183 F. 2d 919 (5th Cir. 1950), cert. denied, 340 U.S. 904. See also *Estate of Lindsay,* 2 T.C. 174 (1943); *Guenzel's Estate* v. *Comm'r,* 258 F. 2d 248 (8th Cir. 1958). In the present case, it becomes necessary, under the rule followed in the above-cited cases, to determine whether the decedent by creating the trust of December 15, 1931, was furnishing consideration for—i.e., whether he was paying for—the subsequent creation of the Janet Grace trust on December 30, 1931. This is a question of fact, which involves an inquiry into the element of motivation. The facts show that when decedent created the Joseph Grace trust, he was not paying for the transfer of the property covered by the Janet Grace trust and that when Janet Grace made such transfers to the Janet Grace trust, she was not induced or caused to do so by reason of the previous establishment of the Joseph Grace trust by the decedent.

Unfortunately, it is necessary to rely largely on circumstantial evidence in making the factual determination that is crucial in the disposition of this case, as both the decedent and Janet Grace were dead at the time of the trial. Consequently, it will be necessary to outline in considerable detail the known facts which appear to be pertinent in drawing inferences with respect to the motivation which led the decedent and Janet Grace to create the trusts of December 15 and 30, 1931.

The decedent and Janet Grace were married in August 1908. Five children, three sons and two daughters, were born to them. One of the daughters died in

1935, but the other four children were living at the time of the trial.

The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not thereafter inherit any substantial wealth. However, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers which the decedent made to her, either directly or indirectly. For example, when the decedent on April 5, 1911, paid the purchase price for and acquired a 167-acre farm on Long Island for the purpose of developing it into a homestead for the family, he caused the legal title to be vested in Janet Grace. Thereafter, the decedent proceeded at great expense to convert the acreage into a country estate for use as the family home. The property was called Tullaroan, and it included among the numerous improvements a 65-room colonial-style residence for the family. Tullaroan became the home of the decedent and Janet Grace in about 1911, and it continued to be their home for the remainder of their lives.

There is in the record evidence concerning 24 transfers of property and financial interests by the decedent to Janet Grace during the period between April 19, 1917, and May 10, 1929. One of these transfers involved 3,000 shares of stock in the Ingersoll-Rand Company having a book value of $300,000, and there were 9 additional instances where property having a book value of $100,000 or more was transferred by the decedent to Janet Grace.

The record also contains evidence regarding the creation by the decedent, during the period between August 26, 1920, and June 5, 1930, of 26 trusts for

the benefit of his children. While in most instances the properties transferred by the decedent to these various trusts had relatively modest book values, the decedent provided 5 of the trusts with properties having book values in excess of $100,000 for each trust.

In addition, the record contains evidence concerning five instances during the period between August 26, 1920, and March 31, 1929, when Janet Grace made transfers of assets to or for the benefit of the decedent or their children. These incidents involved transfers of properties having book values ranging all the way from $3,860.15 to $613,344.32. It is interesting to note that the largest of these transfers, which was shown by the record to have been a gift from Janet Grace to the decedent, in effect involved a retransfer by Janet Grace to the decedent of property which the decedent had transferred to her in the first instance. What Janet Grace transferred to the decedent in that instance was stock in a personal holding company which had been set up on behalf of Janet Grace to hold valuable corporate shares which the decedent had previously transferred to Janet Grace.

The decedent exercised supervision and control over, and he made the decisions that were involved in the management of, the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or dis-

position of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument. Therefore, although there is no direct evidence in the record relative to the circumstances that were involved in the transfers of assets by Janet Grace previously mentioned, it is reasonable to infer that such transfers were made by Janet Grace in accordance with plans devised by the decedent.

In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Company to assist him by handling the details that were involved in carrying out his decisions.

The events that led directly to the creation by the decedent of the trust dated December 15, 1931, and to the creation of the Janet Grace trust on December 30, 1931, began in early December of 1931, when the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company, concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts for the benefit of the family should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with transfers of assets to such trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships. The decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the owner-

ship of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had in his possession drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

Following the conference mentioned in the preceding paragraph, and in accordance with the plan devised by the decedent, he executed on December 15, 1931, a trust instrument which created a trust that will be referred to hereafter in the opinion as "the Joseph Grace trust." William R. Grace, William G. Holloway, and the decedent himself were named in the instrument as trustees of the Joseph Grace trust. The trustees were directed to pay the income from the trust to Janet Grace during her lifetime, and also to pay to her any amounts of the principal which a majority of the trustees might deem advisable. Janet Grace was given the power to designate, by will or deed, the manner in which the trust estate remaining at the time of her death should be distributed to or for the benefit of the decedent and their children.

In connection with the execution of the trust instrument on December 15, 1931, the decedent transferred to the Joseph Grace trust blocks of the capital stock of three corporations, several parcels of real estate, and a one-fourth undivided interest in a certain joint venture which, at the time, owned a tract of land, a number of real estate mortgages, other receivables, cash, and 10,620 shares of common stock in the Ingersoll-Rand Company.

Fifteen days after the creation of the Joseph Grace trust by the decedent, Janet Grace on December 30,

1931, acting in accordance with the plan of the decedent previously mentioned, executed the trust instrument which created the Janet Grace trust. William R. Grace, William G. Holloway, and Janet Grace were named as the trustees of the Janet Grace trust. Under the provisions of this trust, the trustees were to pay the income from the trust property to the decedent during his lifetime, together with any amounts of the principal which a majority of the trustees might deem advisable. Also, the trust instrument directed that, during the life of the decedent, he should be entitled to the use and occupancy of the real property that was included in the trust.

In connection with the execution of the trust instrument referred to in the preceding paragraph, Janet Grace on December 30, 1931, transferred to the Janet Grace trust the family homestead, Tullaroan, and 40 shares of stock in a corporation known as Lundy's Lane Corporation. That corporation was a personal holding company which had been incorporated on behalf of Janet Grace on November 9, 1923. At that time, she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock, and 3,040 shares of W. R. Grace and Company preferred stock, all of which had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of stock in Lundy's Lane Corporation originally owned by Janet Grace, she made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totalling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. After the creation of the Janet Grace trust on December 30, 1931, Janet Grace continued to own 367 shares of stock in Lundy's Lane Corporation,

the decedent owned 100 shares, the Janet Grace trust owned 40 shares, and the five trusts previously created by the decedent for the benefit of his children owned 20 shares each.

The pattern of creating trusts for the benefit of members of the family, and of transferring assets directly to members of the family, continued during the years that followed the creation of the Joseph Grace trust and the Janet Grace trust in December of 1931. Both the decedent and Janet Grace were involved in such actions.

Janet Grace died on December 31, 1937, at the age of 53 years. The Joseph Grace trust terminated with the death of Janet Grace. The estate of Janet Grace filed a Federal estate tax return in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the IRS asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by reductions in the values, as shown on the return, of certain blocks of corporate stock owned by Janet Grace at the date of her death, and by elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the

corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned its counter-contentions.

In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in the preceding paragraph, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the value of the lesser trust (i.e., the Janet Grace trust) that would be taxable as part of the estate of Janet Grace.

The decedent died on July 15, 1950, at the age of 73 years. A Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the decedent's gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent.

Following an examination of the return referred to in the preceding paragraph, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under Section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue

Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate. This deficiency, plus assessed interest in the amount of $55,720.08, was paid by the decedent's estate on July 14, 1954.

A claim for refund was subsequently filed with the Internal Revenue Service on behalf of the decedent's estate. Administrative relief was not obtained, and the present action followed.

A very significant fact in connection with the creation of the Joseph Grace trust and the Janet Grace trust was that, as inferred from the evidence in the whole record, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences. These transfers were part of a well-established pattern of conduct, managed by the decedent, which began as early as 1911, which continued for many years, and which involved numerous transfers of valuable property and financial interests among the members of the family.

It is certainly obvious that the decedent, when he created the Joseph Grace trust on December 15, 1931, was not motivated by any intention to give consideration for, or pay for, the transfer of Tullaroan by Janet Grace to the Janet Grace trust on December 30, 1931, in order that he might obtain the right to the use and enjoyment of the family homestead. As previously indicated, Tullaroan had been the family homestead since about 1911. The decedent had paid the original purchase price for Tullaroan although the title had been taken in the name of Janet Grace, and the decedent had subsequently provided the funds that were

required for the construction of the buildings and other improvements in developing Tullaroan into a country estate (except that an uncle of the decedent bore the cost of making certain additions to the main residence in about 1920). At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan during their lives; and, in fact, they both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust. Consequently, there is no basis in the record for a finding that the decedent created the Joseph Grace trust and transferred property to it in order to induce Janet Grace to transfer Tullaroan to the Janet Grace trust so that the decedent might obtain the right to the use and enjoyment of the family homestead.

It would also be unrealistic to find that the decedent, in creating the Joseph Grace trust on December 15, 1931, intended to furnish consideration for, or pay for, the transfer by Janet Grace of the 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust. That corporation was a personal holding company that had been established on behalf of Janet Grace to hold valuable shares of corporate stock which the decedent himself had previously given to Janet Grace. Actually, as stated heretofore, the inference to be drawn from the whole record is that the decedent, when he created the Joseph Grace trust and transferred property to it, was not motivated by a desire to obtain any sort of property, or interest in property, from Janet Grace. Rather, he was merely continuing a long-established pattern of conduct, and

the immediate motivation was a desire to effect transfers of assets among members of the family before an expected new gift tax became effective.

Conversely, there is no basis in the record for a finding that Janet Grace, in transferring Tullaroan and 40 shares of stock in Lundy's Lane Corporation to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust. Indeed, there is no evidence in the record that Janet Grace even knew about the creation of the Joseph Grace trust by the decedent. Cf. *Hanauer's Estate* v. *Comm'r,* 149 F. 2d 857, 859 (2d Cir., 1945), cert. denied 326 U.S. 770. On the basis of the whole record, it is reasonable to infer that Janet Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so; and that if any explanation at all was given to Janet Grace by the decedent, it was merely to the effect that a probable saving in gift tax could be effected if such actions were taken by Janet Grace before the end of 1931.

However, there remains for consideration a separate line of cases which apply different legal standards in determining the existence of consideration within the meaning of the *Lehman* case. These cases vary somewhat in the statement of the rule, but basically they look at the objective evidence to determine whether trusts created by husband and wife similar to those involved in this case are reciprocal and taxable. In some of these cases, consideration is inferred from the fact that the properties included in the two trusts are of approximately the same amount, that the trusts are created at or about the same time, and that each grantor gives the other a life estate in income, so that the trust would normally be included in his estate

if the grantor had reserved that power to himself. *Cole's Estate* v. *Comm'r*, 140 F. 2d 636 (8th Cir. 1944). Other cases in this group hold that the same inference will be made unless rebutted by clear evidence. *Hanauer's Estate* v. *Comm'r*, 149 F. 2d 857 (2d Cir. 1945), cert denied, 326 U.S. 770; *Orvis* v. *Higgins*, 180 F. 2d 537 (2d Cir. 1950), cert denied, 340 U.S. 810. In still others, the presence or absence of a motive to avoid the payment of estate taxes has been an important factor in deciding the application of the "reciprocal trust" doctrine. *Estate of Louis D. Ruxton*, 20 T.C. 487 (1953). The additional evidence heard at the second trial in this case and the facts found therefrom do not change the result when the rule announced in the above-cited cases is applied here.

It appears from the evidence in the augmented record that Joseph P. Grace never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust on December 15, 1931 and caused his wife to create the Janet Grace trust on December 30, 1931. The evidence also establishes the existence of other logical and even compelling motives for these transactions.

It is true that there is a great deal of evidence in the record, as supplemented in July 1966, about a plan which was being promoted during the period 1930–1931 by Alan Ross, of the Grace National Bank's Trust Department, which involved the creation of trusts by a husband and wife for the benefit of each other, and which had, as one of its supposed advantages, the possibility of ultimately minimizing estate taxes. At that time, both the Grace National Bank and W. R. Grace and Company were controlled by the Grace family, of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same build-

ing in New York City, and Joseph P. Grace maintained his office in that building.

Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. One of the advantages of his plan, according to Mr. Ross, was that it provided a means whereby a husband and wife could equalize the family income between them and thus effect annual savings in income taxes. Mr. Ross also asserted that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

Details concerning the Ross plan, and regarding Mr. Ross' efforts to interest various persons in the plan, are set out in the additional findings 37–41.

Alan Ross never discussed the creation of trusts with Joseph P. Grace. However, in some manner that is not shown by the evidence, Mr. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Some-

time in 1931, Mr. Grace asked Harold J. Roig what the latter thought about the Ross plan. Mr. Roig had formerly been head of the Legal Department of W. R. Grace and Company, was then an official of that company, and occupied an intimate and confidential relationship with Joseph P. Grace. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating that he had not done any legal research on the plan, but that it was his "curbstone" opinion that Mr. Ross' plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

That Joseph P. Grace, in connection with the creation of the Joseph Grace trust and the Janet Grace trust in December 1931, was not attempting to carry out the Ross plan to minimize estate taxes is indicated by the circumstances that Mr. Grace created the Joseph Grace trust on December 15 and caused Mrs. Grace to create the Janet Grace trust 15 days later, or on December 30, 1931, whereas an essential part of the Ross plan to lessen estate taxes was the lapse of a considerable period of time between the creation of trusts by a husband and wife.

Perhaps specific reference should be made to the circumstances that, as indicated in additional finding 46, Joseph P. Grace was aware of the contention made by the Internal Revenue Service after the death of Janet Grace that the Joseph Grace trust and the Janet Grace trust were reciprocal and one of the trusts was includable as part of the taxable estate of Janet Grace; that Mr. Grace preferred not to litigate the issue; and that he instructed counsel for the estate of Janet Grace to go ahead and make the best settlement with the Internal Revenue Service that was possible. Subse-

quently, a compromise agreement was entered into between the Internal Revenue Service and the estate of Janet Grace whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. However, Mr. Grace's willingness to compromise a disputed claim cannot properly be regarded as an admission by him that the Internal Revenue Service was correct in its contention that the two trusts were reciprocal. 4 Wigmore, Evidence § 1061(c) (1940).

[1] The reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace trust and to have his wife create the Janet Grace trust, although Mr. Grace did indicate that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly, in December 1931, because it was his view that a gift tax was "coming along any day now."

Therefore, if we take the view of those cases which impose the burden on the taxpayer to rebut any inference arising under the circumstances of this case that the Janet Grace trust was created in consideration of the trust previously established by the decedent, we think the burden has been met. It has been shown that the two trusts were not created to avoid estate taxes but merely as another step in a long-established pattern of family giving. Thus, since it has been shown that there was substance to the transactions and that they were not merely shams to avoid the imposition of estate taxes, the Janet Grace trust should not be included in the estate of the decedent. Accordingly, plaintiffs are entitled to recover, with the amount of the recovery to be determined pursuant to Rule 47(c).

DAVIS, Judge, dissenting:

I

1. Even on the court's own assumption that subjective motivation is all-controlling, the judgment should go for the Government. Under the rule of the first "line of cases" (as formulated in the majority opinion), I cannot escape the conclusion that Mr. and Mrs. Grace did give "consideration" to each other, in the sense that the establishment of each trust was the quid pro quo for the other, and was intended as such. There is, first of all, the basic finding, adopted by the court, that the trusts "were created by, or at the instigation of, Joseph P. Grace as parts of what was essentially a single transaction." Finding 53. This is far from an overstatement. The decedent was the sole decision-maker in the household; his wife accepted his choices without question, even for her property. Finding 5(a). The creation of two trusts in December 1931 followed this pattern (findings 10 and 45), and there is no possibility that Janet Grace was pursuing an independent course. The two trusts, moreover, were obviously inter-connected; Joseph developed the idea of both at the same time, he had his attorney draw them up simultaneously (findings 10 and 45), the instruments contained very similar provisions and were the same in form (findings 11(a), 12(a), and 13), they were both executed within a short period of time, and both covered substantial properties (findings 11 and 12).[1]

[1] See also the evidence referred to infra as to the decedent's probable tax motivation and the departure from the type of gifts the Graces had been making in the past or would make in the future.

The findings that the trust instrument were signed 15 days apart (findings 11(a) and 12(a)), and that no attempt was

It follows in common sense, as I gauge it, that one of these inter-related trusts was in exchange for the other, one settlor was actually "paying for" the transfer made by the other. Of course, the Graces did not desire to acquire property from one another (finding 15) but neither did the Lehman brothers in the seminal decision and neither do the parties to any reciprocal trust arrangement. That is almost an irrelevant factor since the mutuality is all-important to the parties, not the property content of the individual transfers if they were isolated. Of course, Mrs. Grace as a person was not induced or caused to establish her trust by the previous establishment of Joseph's trust. See finding 12(e). But he was her agent and acted for her in this as in all financial transactions—and *he* obviously wanted the trusts to be related, connected, and interdependent. Since Joseph was the only real moving party and Janet was wholly acquiescent, it is immaterial that there is no evidence of a factual "bargain" between them (see finding 30), or even a tacit understanding (finding 29), and that, quite likely, Janet Grace had no knowledge of her husband's trust (finding 12(e)). It cannot be that the law frees from estate tax a reciprocal trust arrangement where, as here, the wife is the submissive

made to equalize the value of the trust corpora (finding 45(g)) do not swing the balance the other way. The latter would be pertinent for transfers between spouses only in very special circumstances since the distribution of assets between husband and wife is rarely of great consequence and spouses infrequently deal with each other at arm's length. Compare *Estate of Ruxton*, 20 T.C. 487, 494 (1953), with *Cole's Estate* v. *Commissioner*, 140 F. 2d 636, 638 (C.A. 8, 1944). The first is insignificant in light of the finding that the instruments were drafted at about the same time. See *Orvis* v. *Higgins*, 180 F. 2d 537 (C.A. 2), cert. denied, 340 U.S. 810 (1950) (6 day gap); *Estate of Carter*, 31 T.C. 1148, 1151-53 (1959) (1 day); *Estate of Eckhardt*, 5 T.C. 573, 678-79 (1945) (6 days).

instrument of her husband, while imposing the levy where the wife is a sovereign soul who, though making up her own mind, agrees with her spouse to adopt the cross-trust device. Gentlemen with compliant Biancas at their side instead of independent Katherines may enjoy some advantages, but certainly not that one.

2. A separate line of cases, in the court's view, stresses tax avoidance, but the court concludes that "the reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace and to have his wife create the Janet Grace trust * * *." My judgment, to the contrary, is that the taxpayers have failed to bear their burden of proving the absence of estate tax motivation.[4]

The majority concludes that this motive is negated, in the main, by the facts that Joseph Grace desired to avoid the impending gift tax (findings 10 and 15), and that the Graces had a longstanding practice of intra-family donations (findings 7–9 and 16–17), including a great number of trusts (finding 32). However, the wish to by-pass the gift tax is by no means inconsistent with a desire to avoid the estate tax as well, especially when, as is conceded, both trusts were deliberately part of a single undertaking. Cf. *Orvis* v. *Higgins, supra*, 180 F. 2d 537, reversing 80 F. Supp. 64, 72, 74 (S.D.N.Y. 1948); *Estate of Carter, supra*, 31 T.C. at 1152 Nor does the history of intra-family generosity and the decedent's "trust-mindedness" support the conclusion. This pattern does not include, so

[4] The estate has the task of showing that it is entitled to recover under the governing rules. See *Orvis* v. *Higgins, supra*, 180 F. 2d at 541; *Estate of Eckhardt, supra*, 5 T.C. at 680; *Estate of Lindsay*, 2 T.C. 174, 177 (1943).

far as the findings show, a single reserved life estate to the other spouse, much less cross-life-estates, in property transferred to the children; nor does it show that the Graces had ever made simultaneous transfers to one another. The uniqueness of these two December 1931 transfers suggests strongly that they were linked to each other, not to any post or ante family practice, and that they had a special purpose. Cf. *Estate of Carter, supra,* 31 T.C. at 1154. No non-tax reason has been given us why, in this instance, the Grace pattern of generosity to kin worked itself out through this unusual mechanism of interdependent cross-trusts—and I can think of none.

True, there is no direct evidence that the decedent actually had tax avoidance in mind. We do know, however, that he thought and talked about the supposed tax advantages of concurrent trust transfers between spouses. Alan Ross, an executive in the Trust Department of the Grace National Bank, was an advocate of reciprocal trusts as a mode of minimizing estate taxes (findings 36 and 37(c)); though Joseph Grace was not proved to have had direct contact with Ross on this subject, he was aware of the Ross plan and discussed it with Harold J. Roig, an executive of W. R. Grace and Company and a confidant of Joseph's (Roig recommended against it) (findings 39 and 44); various Grace business executives and friends or relatives of the decedent either knew of and talked about the idea or had been approached by Ross to execute such trusts[5] (findings 38-42);[6] contrary to

[5] Among those whom Ross tried to convert were Harold J. Roig (finding 39); W. R. Grace, brother of Joseph and a trustee for each of the Grace trusts involved here (finding 40); and D. S. Iglehart, president of the Grace company and a longtime friend of the decedent (finding 41). Apparently, of these, only Iglehart was inclined to follow Ross's plan. Findings 39-41. Although he did not hew to every aspect of the idea, the

decedent's custom, he presented J. Morden Murphy (who handled most of the Grace family's financial affairs) with a prepared draft of the Joseph Grace trust and possibly the Janet Grace trust for use as models (findings 35 and 45(f)); these drafts were very similar to the cross-trust instruments drawn by Alan Ross for D. Stewart Iglehart, a personal friend of Joseph Grace and president of W. R. Grace and Company (findings 41, 42, and 45 (f)) (see footnote 3). In addition, although this is not included in the findings, the draft trust instrument which Joseph brought with him, unlike any previously executed by him, designated the Grace National Bank as a trustee and—significantly—was prepared for the signature of Alan Ross on behalf of the bank.

This clear nexus between Joseph and the Ross tax-avoidance device—together with the lack of any other plausible reason for the cross-life-estates and their uniqueness in the Grace annals—persuade me of the probability that the decedent's actions had a distinct estate tax coloration. At a minimum, the plaintiffs have not succeeded, for me, in their job of persuasion.

II

1. But the most damaging crack in the foundation of the court's opinion comes from its hydraulic stress on subjective motivation far beyond its proper weight.

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evidence supports the conclusion that he hoped to save some estate taxes when he and his wife executed the trust instruments drawn by Ross. The scheme was also a topic of discussion among the personnel of the Customer Securities Department (J. Morden Murphy, and A. S. Rupley) and of the Legal Department (H. N. Deyo, A. B. Shea, and Cogswell). Finding 38. Finally, the record indicates that W. G. Holloway, a nephew of the decedent and a trustee on both trusts, knew of the plan although it is not clear whether he was fully aware of the estate tax implications.

Even though the trusts were admittedly part of one transaction, the court still seeks to find whether the settlors actually intended to induce each other to enter into the arrangement and to "pay for" the other's transfer, whether they actually intended to lessen estate taxes, and whether they were actually dominated by other motives. "Putting the wrong question is not likely to beget right answers even in law." *Vanston Bondholders Protection Comm.* v. *Green,* 329 U.S. 156, 170 (1946) (Frankfurter, J., concurring). As I understand the reciprocal trust doctrine stemming from *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2), cert denied, 310 U.S. 637 (1940), the correct question—once the cross-trusts are seen as inter-dependent (as has been found here)—is whether the trusts created by the two settlors put both in approximately the same economic position, objectively, as they would have been in if each had created his own trust without invoking or using the other as beneficiary. See Lowndes, Consideration and the Federal Estate and Gift Taxes: Transfer for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts, 35 Geo. Wash. L. Rev. 50, 80 (1966). The essential purpose is to prevent a reciprocal arrangement from canceling the effect of an ostensibly complete inter vivos conveyance which on its face severs the settlor completely from the transferred assets.[6]

[6] The background of reciprocal trusts is discussed in Colgan & Molloy, Converse Trusts—The Rise and Fall of a Tax Avoidance Device, 3 Tax L. Rev. 271 (1948). Congress has, in effect, approved the doctrine's effort to close the loophole. In the Technical Changes Act of 1949, ch. 720, § 6, 63 Stat. 891, 893-94, it permitted those who had used the device prior to 1940 to give up their control over a reciprocal trust without paying a gift tax on the relinquishment. The Senate Finance Committee noted

The estate tax is, of course, designed to tax transfers of property made at death. Congress recognized, however, that such an impost could not be effective unless there were some restrictions on inter vivos transfers. Through Section 811 it sought to "include in the gross estate inter vivos gifts 'which may be resorted to, as a substitute for a will, in making disposition of property operative at death.'" *Helvering* v. *Hallock*, 309 U.S. 106, 114 (1940). We have been taught by *Estate of Spiegel* v. *Commissioner*, 335 U.S. 701 (1949), that—once a "transfer" is shown—the critical test is the objective situation, not whether the decedent in his own mind resorted to the inter vivos transfer as a means of testamentary disposition.

In *Spiegel* the Court held, inter alia, that taxability under Section 811(c)(1)(C) "does not hinge on a settlor's motives, but depends upon the nature and the effect of the trust transfer." It is "immaterial" whether the interest upon which inclusion is premised "remains in the grantor because he deliberately reserves it or because, without considering the consequences, he conveys less than all of his property ownership." Any other approach, "such as a post-death attempt to probe the settlor's thoughts in regard to the transfer, would partially impair the effectiveness of the * * * provision as an instrument to frustrate tax evasions." 335 U.S. at 705–06. Although the Court was applying Section 811(c)(1)(C) (transfers "intended to take effect in possession or enjoyment" at the transferor's death), its reasoning applies with at least equal force to Section 811(c)(1)(B), involved

that, prior to Lehman, the device had been used "with the apparent intent of minimizing estate taxes" and that Lehman "put taxpayers on notice as to the probable tax consequences of reciprocal trusts in the future." S. Rep. No. 831, 81st Cong., 1st Sess., at 5–6 (1949), reprinted in 1949-2 Cum. Bull. 289, 292.

here, which is framed in still more objective terms.[7]

If taxability turns on states of mind, the "difficulty of searching the motives and purposes of one who is dead" is likely to render estate taxes on inter vivos transfers "a weak and ineffective means of compensating for * * * the withdrawal of vast amounts of property from the operation of the estate tax." *Heiner* v. *Donnan,* 285 U.S. 312, 343 (1932) (Stone, J., dissenting); see *Bittker, The Church* and *Spiegel* Cases: Section 811(c) Gets a New Lease on Life, 58 Yale L.J. 825, 835–37 (1949). In addition, family arrangements which appear entirely comparable in their actual impact will receive different tax treatment dependent on amorphous testimony as to states of mind.

Avoidance of this danger by not inquiring into motives is more strongly justified when the truly non-tax reasons for a particular form of arrangement are rare, at best. Cross-trusts which are shown to be truly reciprocal definitely have this characteristic. Originally developed by enterprising attorneys during the 1930's as a tax avoidance device, nothing in their history indicates that they were engineered to fulfill any other function. See note 4 supra. Focusing on the beneficial interest or power granted to a decedent, one is hard put to find a purpose other than tax avoidance or, if the decedent was not fully aware of the tax implications, the aim of achieving some substitute for a will in disposing of property at death—to give the property at life's end but to keep a grasp on it while life lasts. See *Orvis* v. *Higgins, supra,* 180 F. 2d at 540–41; *Estate of Carter, supra,* 31 T.C. at 1153–54; *McLain* v.

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[7] Even as to the word "intended", the Court pointed out in *Commissioner* v. *Estate of Church,* 335 U.S. 632, 638 (1949), that the historic test of "'intended' was not a subjective one, * * * the question was not what the parties intended to do, but what the transaction actually effected as to title, possession and enjoyment."

Jarecki, 232 F. 2d 211, 213–14 (C.A. 7, 1956) (dissenting opinion). The short of it is that, first, the obstacles to a fair determination of the actual subjective intent of the decedent are many and heavy; second, there is the highest probability that, by an interdependent reciprocal-trust arrangement, a decedent desires to avoid estate taxes or at least to achieve the type of transfer the estate tax is designed to assess (postponement until the transferor's death of relinquishment of his right to possess and enjoy the property); and, finally, in the remote instance in which the decedent has some other curious purpose, the objective fact, whether he knows or desires it or not, is that he is tieing a string to the very property he purports to give completely away.[8]

2. This objective standard comes into play only after it is found that the cross-trusts are truly reciprocal,

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[8] In *Spiegel* the Court held that an infinitesimal reversionary interest arising by operation of state law was enough to bring the transferred property within the decedent's gross estate under the portion of Section 811(c) covering transfers "intended to take effect in possession or enjoyment" at death. Shortly afterwards, Congress repudiated this particular result when applied to transfers made before October 8, 1949, by requiring (1) that the reversionary interest be expressly reserved in the trust instrument and (2) that the value of the interest exceed 5 percent of the value of the property transferred. See Technical Changes Act of 1949, ch. 720, § 7(a), 63 Stat. 891, 895, as amended by Technical Changes Act of 1953, ch. 512, § 207, 67 Stat. 615, 623. However, there is no indication that Congress, even through this express-reservation requirement, meant to make the transferor's subjective intent a crucial factor for taxation. See Bittker, Church and Spiegel: The Legislative Sequel, 59 Yale L.J. 395, 410 (1950). But cf. *Estate of Marshall,* 16 T.C. 918, 921–23 (1951), aff'd, 203 F. 2d 534 (C.A. 3, 1953). As for transfers after October 7, 1949, the statutes do not require that the reversionary interest be specifically reserved See Int. Rev. Code of 1954, § 2037(a)(2); Technical Changes Act of 1949, supra, § 7(a).

connected, interdependent; and in making the latter determination subjective intent does have its role. Clearly the estate tax permits a person during his lifetime to rid himself of property, and it also allows him to receive a beneficial interest in or power over the trust of another without necessarily having the corpus included in his estate. There is no doubt that this is true even if the chance effect of such independent transfers is to leave him in the exact situation he would have been in had he transferred his property retaining an interest or power similar to that granted by his benefactor. We can borrow an illustration from O. Henry's "Gift of the Magi", transforming it in milieu and feeling-tone. Suppose Janet Grace were a self-reliant woman and, consulting her own attorneys and advisers, independently and secretly decided to make a Christmas present to Joseph and her children in December 1931 by setting up the Janet Grace trust. Moved in the same way and unaware of Janet's plan, Joseph also decided, secretly, to make that kind of holiday gift to his family by establishing the Joseph Grace trust. On Christmas morning, the two executed trusts would appear to an outsider to be reciprocal and interdependent, but from the background we would know that that was not so. The appearance would mask the reality.

In the technical terms of the statute (§ 811(c)(1)(B)) the inquiry into true reciprocity and interdependence assesses whether the decedent made a "transfer", even though he was not the nominal settlor. If the cross-trust arrangement was mutual and interdependent, there is such a "transfer"; if the crossing of the trusts was haphazard, not pre-arranged, not part of a plan, there is no "transfer". To that extent the background of the transaction, including subjective motives, is relevant. Motivation is used to determine

the link between the trusts, and not, as a separate question, what the parties hoped or wanted to accomplish from their plan. The interdependence, in and of itself, furnishes the only "consideration" which the reciprocal trust doctrine should demand.

In the present case the findings and record show that the crossing was not haphazard but part of a single, interdependent transaction. See Part I of this opinion, supra. Accordingly there was a "transfer" by Joseph of the assets of the Janet trust, just as there was a "transfer" by Janet of the property in the Joseph trust. Those mutual transfers left Joseph, up to the limits of his wife's trust, in the same position as if he had given himself, rather than his wife, the life interest under the Joseph trust. If he had done that directly, the tax would admittedly be due under § 811 (c)(1)(B), no matter what his subjective motivation for creating the life interest. The estate should not escape because the same result came in more roundabout fashion. There is no need to delve further into Joseph Grace's intentions or motives.

3. This analysis is, I believe, consistent with the results, though not with all the language in a few of the opinions, in the estate tax reciprocal-trust cases of which we are aware.[9] The basic rationale of many, probably most, of the decisions is affirmatively in accord. Included are those cases emphasizing interdependence and, once that is found, holding the tax due without much more in the way of facts.[10] Quite

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[9] I do not discuss the non-estate tax cases, which often present complicating problems.

[10] See *Estate of Moreno* v. *Commissioner*, 260 F. 2d 389, 392 (C.A. 8, 1958); *Orvis* v. *Higgins*, *supra*, 180 F. 2d at 540; *Hanauer's Estate* v. *Commissioner*, 149 F. 2d 857, 858 (C.A. 2), cert. Denied, 326 U.S. 770 (1945); *Estate of Carter*, *supra*, 31 T.C. at 1154; *Estate of Newberry*, 6 T.C.M. 455 (1947), aff'd per curiam, 172 F. 2d 220 (C.A. 3, 1948); *Estate of Eck-*

explicit are *Cole's Estate* v. *Commissioner, supra,* 140 F. 2d 636, and *Hanauer's Estate* v. *Commissioner, supra,* 149 F. 2d 857. Cole's Estate upheld a Tax Court decision "based upon the legal effect of the trust agreements coupled" with the finding that " 'the property of the wife was in effect exchanged for that of the husband.' " 140 F. 2d at 637, 638. It further held that " 'with few exceptions the law attaches legal consequences to what the parties do quite independently of their private purpose or intent.' " 140 F. 2d at 638. Similarly, *Hanauer's Estate, supra,* concluded that "the two trust indentures were contemporaneously developed and executed as though all part of a single transaction" and that, "[t]here being no contention that the decedent's transfer was one in contemplation of death, his motive was not controlling." 149 F. 2d at 859.

The few opinions which seem to insist, in part, on a conscious, subjective bargain-and-exchange seem to rest on a determination that the crossed trusts were not in fact interdependent. In *Newberry's Estate* v. *Commissioner,* 201 F. 2d 874, 875 (C.A. 3, 1953), the husband gave unrebutted testimony "that he would have created his trusts regardless of whether Mrs. Newberry had decided upon a similar course." The trusts were created fifteen months apart in *In re Leuders' Estate,* 154 F. 2d 128, 132 (C.A. 3, 1947), and there was very little indication of interdependence. *McLain* v. *Jarecki,* 232 F. 2d 211, 213 (C.A. 7, 1956), is not so clear, but the court seems to have treated the "donative state of mind once extant" be-

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hardt, supra, 5 T.C. at 680, 682; *Estate of Fish,* 45 B.T.A. 120, 125 (1945); *cf. Blackman* v. *United States,* 98 Ct. Cl. 413, 426–27, 48 F. Supp. 362, 368 (1943). Compare *Estate of Ruxton, supra,* 20 T.C. at 494; *Estate of Resch,* 20 T.C. 171, 183 (1953); *Estate of Lindsay, supra,* 2 T.C. at 177, 179.

tween the spouses as showing that each was pursuing an independent course.[11] "The decisions are thus distinguishable, but to the extent the opinions reflect adherence to the narrow view that an actual subjective bargain is necessary, I would reject them as contrary to the aims of the estate tax provisions on inter vivos transfers and out of harmony with the bulk of the jurisprudence on this point.

For these reason I dissent and would hold that the taxpayers are not entitled to recover.

NICHOLS, Judge, joins the foregoing dissenting opinion.

FINDINGS OF FACT

1. This case is a suit for refund of Federal estate taxes and interest thereon paid by the Estate of Joseph P. Grace, Deceased.

2. Joseph P. Grace, the decedent whose estate is here involved (hereinafter sometimes called "the decedent"), and Janet Grace were husband and wife. They were married in August 1908.

3. (a) The following children, born on the dates indicated, are the surviving offspring of the marriage of the decedent and Janet Grace:

> Joseph Peter Grace, Jr. (hereinafter sometimes called "Peter"), May 25, 1913.
>
> Michael P. Grace, II (hereinafter sometimes called "Michael"), August 6, 1917.
>
> Janet Maureen Grace (hereinafter sometimes called "Maureen"), December 27, 1924.
>
> Charles MacDonald Grace (hereinafter sometimes called "Charles"), September 13, 1926.

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[11] Estate of *Guenzel* v. *Commissioner*, 258 F. 2d 248, 252, 254 (C.A. 8, 1958), contains dicta suggesting the bargain-and-exchange approach, but also quotes the broader formulation of *Cole's Estate*, *supra*.

(b) Another child, Nora Grace (hereinafter sometimes called "Nora"), was born to the decedent and Janet Grace. Nora died on August 25, 1935.

4. The decedent was a man of great wealth at the time of his marriage to Janet Grace, and thereafter. Janet Grace, on the other hand, had no wealth or property of her own at the time of her marriage to the decedent, and she did not thereafter inherit any substantial wealth. However, as indicated in subsequent findings, Janet Grace acquired the ownership of extensive property and financial interests during her marriage to the decedent as the result of transfers made by the decedent to her.

5. (a) The decedent exercised supervision and control over, and he made the decisions that were involved in the management of, the business affairs of the family. In performing this function, he made the decisions regarding the management and disposition of the property and financial interests that were in the ownership of Janet Grace. The latter did not concern herself with business matters, but relied on her husband's judgment as to such matters. Janet Grace's time and attention were devoted to her home and to society, music, the theater, the arts, and civic affairs. When the decedent decided that some formal action by Janet Grace was required in connection with the management or disposition of a piece of property or a financial interest that was in her ownership, the decedent customarily would have the appropriate instrument prepared for his wife's signature, and he would then have her execute such instrument.

(b) In managing the business affairs of the family, including the property and financial interests that were in the ownership of Janet Grace, the decedent utilized the services of the Customers' Securities Department of W. R. Grace and Company to assist him

by handling the details that were involved in carrying out his decisions.

6. (a) Beginning in about 1911 and continuing thereafter as long as the decedent and Janet Grace lived, their family homestead was a large country estate known as Tullaroan, which was situated near Lakeville in the town of North Hempstead, Nassau County, Long Island, New York. When Tullaroan was first acquired for the Grace family on April 5, 1911, it consisted of a substantial farmhouse located on approximately 167 acres of land. The decedent promptly undertook the development and improvement of the property into a homestead for his family. The improvements ultimately included a 65-room colonial-style house for the family residence, several smaller dwellings for members of the household staff, an indoor tennis court, two swimming pools, a polo field, three greenhouses, a garage, a stable, a dog kennel, two cow barns, a bull pen, a pig sty, two chicken houses, and a well and pumphouse to provide a water system for the property. The grounds around the main house were extensively terraced and landscaped.

(b) The decedent paid the purchase price for Tullaroan when it was acquired on April 5, 1911, although title to the property was taken in the name of Janet Grace. The decedent also paid for the construction of the buildings and other improvements at Tullaroan, except that the decedent's uncle, Michael P. Grace, paid for substantial additions to the main residence in about 1920.

7. (a) During the period between April 19, 1917, and July 20, 1926, the decedent transferred property and financial interests to Janet Grace, as indicated in the following table:

Date of transfer	Property transferred	Book value
4-19-17	3,000 sh. Ingersoll-Rand Co	$300,000.00
5-12-17	1,600 sh. W. R. Grace & Co. 2d. Pfd.	160,000.00
5-12-17	1,600 sh. W. R. Grace & Co., Common	160,000.00
6-14-18	250 sh. Ingersoll-Rand Co	25,000.00
6-14-18	1,000 sh. W. R. Grace & Co., Common	100,000.00
3-27-19	20,000 sh. Grace Bros. & Co., Ltd	48,686.00
3-27-19	1,106 sh. W. R. Grace & Co., 2d. Pfd	114,100.00
3-27-19	1,500 sh. Ingersoll-Rand Co	150,000.00
12-31-19	1,000 sh. W. R. Grace & Co., Common	100,000.00
12-31-19	1,000 sh. Ingersoll-Rand Co	100,000.00
12-31-20	Smoketown Property	4,409.73
5-3-22	325 sh. Ingersoll-Rand	32,500.00
6-5-22	50 sh. A&P SS Co., Common	5,000.00
6-6-22	334 sh. W. R. Grace & Co., 2d. Pfd	33,400.00
11-8-23	756 sh. W. R. Grace & Co., Pfd	75,600.00
11-8-23	[illegible] sh. The Evergreens	6,435.00
11-8-23	150 sh. Terminal Whse. Co	9,104.46
11-8-23	400 sh. National City Bank of N.Y.	113,148.5[illegible]
11-8-23	100 sh. National City Co	no value
11-8-23	66 sh. Lincoln Safe Deposit Co	12,660.00
12-20-23	Cash	25,000.00
7-20-26	Cash (loans treated as gifts)	135,000.00
7-20-26	Tennis Court Building	97,725.97

(b) On May 10, 1929, the decedent deeded to Janet Grace a large tract of land known as the Arthur Farm Property, which was located immediately adjacent to Tullaroan. At the time of the transfer, this property had a book value of $72,715.18.

8. (a) During the period between August 26, 1920, and June 5, 1930, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Peter	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Michael	0
8-26-20	8,000 sh. Grace Bros. & Co., Ltd	Nora	$97.37
1-15-25	8,000 sh. Grace Bros. & Co., Ltd	Maureen	24,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Peter	3,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Michael	3,000.00
2-2-26	1,000 sh. Grace Bros. & Co., Ltd	Nora	3,000.00
2-17-26	1,000 sh. Grace Bros. & Co., Ltd	Maureen	3,000.00
7-9-26	666 sh. Ingersoll-Rand Co	Maureen	22,282.82
12-1-27	900 sh. Ingersoll-Rand Co	Nora	18,453.68
1-5-28	966 sh. Ingersoll-Rand Co		
	166 sh. W.R. Grace & Co., Common		
	9,000 sh. Grace Bros. & Co., Ltd		
	15 sh. The Evergreens		
	$5,000 Lake Shore Michigan, So. 4% 1928		
	5,000 United Kingdom 5½% 1937		
	2,000 Mead Pulp & Paper 5% 1934		
	1,000 Ingersoll-Rand Co. 5% 1935		
	1,000 Grace Nitrate Co. 6% 1942		
	3,000 Terminal Warehouse 5% 1942	Charles	60,210.44
4-30-29	60 sh. United Aircraft & Transport Corp	Peter	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Michael	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Nora	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Maureen	1,800.00
4-30-29	60 sh. United Aircraft & Transport Corp	Charles	1,800.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Janet	750.00
7-26-29	$1,000 Kansas City & Southern Railway Co., 1st Mtg., 3% Bond.	Charles	750.00
4-4-30	20 sh. Lundy's Lane Corp	Peter	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Michael	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Nora	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Maureen	107,281.71
4-4-30	20 sh. Lundy's Lane Corp	Charles	107,281.71
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Peter	750.00
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Michael	750.00
6-5-30	$1,000 Kansas City & Southern Ry. Co., 1st Mtg. 3% Bond.	Nora	750.00

9. During the period between August 26, 1920, and March 31, 1929, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children.

Date	Book value	Description
8-26-20	$100,000.00	20,000 shares Grace Bros. & Co., transferred to account of children.
12-21-24	25,000.00	Transfer to Joseph P. Grace and Janet Grace, as Trustees for Maureen.
9-1-26	10,000.00	Joseph P. Grace, loan-gift.
1-5-28	3,860.15	35 shares, The Evergreens, gift Joseph P. Grace.
3-31-29	613,344.32	Gift to Joseph P. Grace, 200 shares of Lundy's Lane Corp.

10. In early December of 1931, the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace and Company (see finding 5(b)), concerning the creation of additional trusts by the decedent and Janet Grace. The decedent believed that a new gift tax would probably be enacted and become effective early in 1932, and he had decided that additional trusts should be created prior to the close of 1931 in order to avoid paying the new gift tax in connection with the transfers of assets to the trusts. Mr. Murphy furnished to the decedent balance sheets that were maintained for the decedent and Janet Grace, showing the capital assets in their respective ownerships; and the decedent, in consultation with Mr. Murphy, selected the various properties in his ownership and in the ownership of Janet Grace that should be included in the trusts that were to be created by the decedent and Janet Grace. At the time of the conference with Mr. Murphy, the decedent had with him drafts of trust instruments that were to be executed by the decedent and Janet Grace, except for the listing of the properties that were to be included in the respective trusts.

11. (a) Following the conference with J. Morden Murphy referred to in finding 10, and in accordance with the plan of the decedent mentioned in that finding, the decedent on December 15, 1931, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Joseph Grace trust." This trust instrument provided in part as follows:

> I, Joseph P. Grace, River House Rd., Manhasset of the County of Nassau, State of New York, hereby constitute William R. Grace, Old Westbury Rd., Old Westbury; William G. Holloway, Store Hill Rd., Old Westbury; and

Joseph P. Grace, Power House Rd., Manhasset and their successors Trustees of the property described in Schedule "A" hereunto annexed, which property I have transferred, delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations.

First: I direct the said Trustees to hold the same in trust during the life of my wife, Janet Grace, and to pay the entire net income therefrom to her during her life, together with any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time in their sole discretion deem advisable.

Second: I direct the said Trustees, upon the death of my said wife, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such one or more of our issue and myself as my said wife may by will or deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as she may provide in such appointment, or to the extent that she may not effectively appoint the same, to pay the same to our issue then surviving in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said wife a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I reserve during my life and I give to my said wife after my death the right to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property, real or

personal, in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further reserve during my life and I give to my said wife after my death the right to direct the exchange of any property, real or personal, held hereunder for the stocks, bonds or other securities of any corporation to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property, and through the voting of proxies issued to me and/or my nominees or after my death to my said wife and/or her nominees by authority hereof, to manage and control any corporation the stock of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the individual Trustees herein named or of any of their successors, I direct that my said wife, or, if she be dead, the remaining Trustees shall have the power to name an individual or a bank or corporation empowered by law to act in such a capacity, to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, the decedent on December 15, 1931, transferred to the Joseph Grace trust the following assets, previously selected by the decedent as indicated in finding 10: 300 shares of the capital stock of the Gilchrest Realty Corporation; 329⅙ shares of the capital stock of Belgrave Realty, Inc.; 150 shares of the capital stock of

the Thomaston Corporation; certain real estate referred to as Thomaston Cottage #5, Bell-Brookhaven-Lot 26, 310–312 East 37th Street, and the Yaphank property; and a one-fourth undivided interest in a certain joint venture known as the Grace Harbor Account.

(c) The Gilchrest Realty Corporation was a real estate development company whose assets consisted principally of improved and unimproved properties located on Long Island, New York, including unimproved lots held for sale and improved commercial rental properties, most of which represented the remaining unsold portion of a 58-acre tract of land, with buildings, known as Smith Farm, which the corporation had acquired at the time of its organization in 1916 and had subsequently subdivided, sold lots out of, constructed additional buildings and improvements upon, and otherwise dealt with, plus real estate mortgages derived from sales of such property. The 300 shares of Gilchrest Realty Corporation transferred by the decedent to the Joseph Grace trust represented 20 percent of the 1,500 shares then outstanding, and were all of the shares of the Gilchrest Realty Corporation which the decedent owned. The decedent had acquired 294 of these shares by gift from Lillius Grace, his mother, in 1917, had received 1 share from her estate in 1923, and had purchased 5 shares in or about 1917. The decedent received no dividends on this stock while it was held by him, nor were any dividends received on this stock by the Joseph Grace trust from the date of the creation of that trust to its termination on December 31, 1937.

(d) Belgrave Realty, Inc., was a real estate development corporation whose assets consisted principally of the remaining unsold portion of a 59-acre tract of land located on Long Island, New York, and

known as Allen Farm, which the corporation had acquired in 1916 and had subsequently subdivided and sold lots out of, as well as mortgages and cash derived from the sale of lots. The 329⅙ shares of Belgrave Realty, Inc., which the decedent placed in the Joseph Grace trust represented 21.94 percent of the 1,500 shares then outstanding, and were all of the shares of Belgrave Realty, Inc., which the decedent then owned. The decedent had acquired 100 shares of this stock from his mother's estate in 1926, 166⅔ shares were distributed to him by a holding company in 1927, and 50 shares and 12½ shares were received in 1929 and 1930, respectively, from the estate and a testamentary trust under the will of his uncle, Michael P. Grace. No dividends were received by the decedent from Belgrave Realty, Inc., while he held this stock, but the Joseph Grace trust received certain "extraordinary dividends" thereon in 1933 and 1937.

(e) The Thomaston Corporation was a holding or investment company whose assets consisted of common and preferred stocks of various corporations. The 150 shares of Thomaston Corporation stock which the decedent transferred to the Joseph Grace trust on December 15, 1931, represented 19.74 percent of the 760 shares then outstanding, all of which were owned by the decedent prior to that transfer in trust. The decedent had acquired all of the 760 shares on November 8, 1923, in exchange for securities transferred to the corporation. The 150 shares of Thomaston Corporation were distributed to Janet Grace on April 27, 1932, upon directions from the decedent and one of the other two trustees, "in accordance with the power conferred upon them by the first clause of the indenture of 12/15/31." On the same date, Janet Grace made a gift of the same 150 shares of Thomaston Corporation to the decedent.

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(f) The real properties referred to as Bell-Brookhaven-Lot 26 and the Yaphank property were unimproved lands situated in the town of Brookhaven, Suffolk County, Long Island, New York. The Yaphank property was a large tract of about 1,000 acres. Bell-Brookhaven-Lot 26 consisted of a long, narrow strip between Great South Bay and the Atlantic Ocean, about 125 feet in width and running about 1,251 feet in length between the two bodies of water. Bell-Brookhaven-Lot 26 had been purchased by the decedent on December 21, 1926, at a cost of $56,905.32. The Yaphank property had been purchased by the decedent on August 24, 1928, at a cost of $69,532.50.

(g) The properties known as Thomaston Cottage #5 and 310-312 East 37th Street were improved rental properties having market values of $3,750 and $47,500, respectively, at the date of the creation of the Joseph Grace trust. Thomaston Cottage #5 had been owned by the decedent since July 6, 1893, when he acquired it by deed from his mother, Lillius Grace. The 310-312 East 37th Street buildings had been purchased by the decedent on May 2, 1928, at a total cost of $65,737.16.

(h) The Grace Harbor Account was a real estate development joint venture formed on October 1, 1927, between the five beneficiaries under the will of the decedent's mother, Lillius Grace, and the Gilchrest Realty Corporation, whereby certain real estate belonging to the estate was transferred to the corporation, which undertook to develop, improve, and sell the property, accounting to the beneficiaries for the proceeds thereof; and there was also transferred to the corporation, for the purpose of financing development costs, certain mortgages and 13,275 shares of the common stock of Ingersoll-Rand Company, in which

each of the beneficiaries owned an undivided one-fifth interest. The decedent originally owned an undivided one-fifth interest in the Grace Harbor Account; but one of the five owners withdrew in 1928, leaving the decedent owning a one-fourth undivided interest, which he placed in the Joseph Grace trust. At the time of the creation of the Joseph Grace trust, the assets of the Grace Harbor Account consisted principally of the unsold (or sold and reacquired) portion of a tract of land known as Gracefield or Grace Harbor, a number of real estate mortgages, other receivables and cash, and 10,620 shares of Ingersoll-Rand common stock. Gracefield or Grace Harbor originally consisted of about 177 acres, but this tract had been developed and portions of it had been sold prior to the creation of the Joseph Grace trust.

12. (a) On December 30, 1931, Janet Grace, acting in accordance with the plan of the decedent mentioned in finding 10, executed a trust instrument which created a trust that will be referred to hereafter in the findings as "the Janet Grace trust." The trust instrument provided in part as follows:

> I, Janet Grace, of the County of Nassau, State of New York, hereby constitute William R. Grace, William G. Holloway and Janet Grace and their successors Trustees of the property described in Schedule "A" hereunto annexed, which property I have transferred and delivered and hereby assign, transfer, convey and set over to them in trust, subject to the following conditions, powers, rights and limitations:
>
> *First:* I direct the said Trustees to hold the same in trust during the life of my husband Joseph P. Grace and to pay the entire net income therefrom to him during his life together with any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them

may at any time or from time to time deem advisable. I further direct that during the life of my said husband he shall be entitled to the use and occupancy of the real property described in Schedule "A" hereunto annexed or such part thereof as shall not have been conveyed to him in fee pursuant to the provisions of the clause "First".

Second: I direct the said Trustees, upon the death of my said husband, to dispose of the balance of the said trust estate then remaining in their hands, together with all unexpended income thereon, to or for the benefit of such one or more of our issue and myself as my said husband may by Will or Deed nominate and appoint to receive the same, and in such proportions and on such terms and conditions as he may provide in such appointment, or to the extent that he may not effectively appoint the same, to pay the same to our issue then surviving, in equal shares per stirpes, or in default of such issue, to pay the same to those persons who would be entitled thereto if I had died at the date of death of my said husband a resident of the State of New York, intestate and possessed of the same, consisting solely of personal property.

Third: I give to my said husband the right during his life and I reserve the right after his death to direct the Trustees to retain any investment at any time held hereunder and to direct the sale or exchange of any such investment and to designate the stocks, bonds or other property real or personal in which the trust estate or any reinvestment thereof shall be invested and to direct the issuance of voting proxies under any stocks held hereunder. I further give to my said husband the right during his life and I reserve the right after his death to direct the exchange of any property, real or personal held hereunder for the stocks, bonds or other securities of any corporation

to be formed pursuant to the laws of any jurisdiction whatsoever for the management of such property and through the voting of proxies issued to my said husband and/or his nominees or after his death to me and/or my nominees by authority hereof, to manage and control any corporation, the stock of which may at any time be held hereunder. Any such direction made by my said husband or after his death by me shall be in writing and the Trustees are hereby specifically released from all liability for any loss arising from any action taken or omitted to be taken by them at the direction of my said husband or after his death at my direction and from any action taken or omitted to be taken by my said husband and/or his nominees or after his death by me and/or my nominees pursuant to any proxy or proxies issued at his direction and with respect to any corporation controlled by him, the stocks, bonds or other securities of which may at any time be held hereunder. * * *

Fourth: I reserve the right for myself or for any other person to increase the trust estate by delivering, bequeathing or devising property or making insurance policies payable to the Trustees for that purpose.

* * * * *

Eighth: In the event of the death, resignation or removal of any of the Trustees herein named or of any of their successors, I direct that my said husband, or if he be dead, the remaining Trustees shall have the power to name an individual or a bank or corporation empowered by law to act in such a capacity to serve as successor Trustee in the place and stead of any such former Trustee. * * *

(b) In connection with the execution of the trust instrument referred to in paragraph (a) of this finding, Janet Grace on December 30, 1931, transferred

to the Janet Grace trust the following assets, previously selected by the decedent as indicated in finding 10: Tullaroan (see finding 6) and 40 shares of stock in a certain corporation known as Lundy's Lane Corporation.

(c) At the time of the creation of the Joseph Grace trust and the Janet Grace trust, there was no indication that either Janet Grace or the decedent ever expected to leave Tullaroan during their lives; and, in fact, both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet Grace, and their children as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust.

(d) Lundy's Lane Corporation was a personal holding company incorporated on behalf of Janet Grace on November 9, 1923, at which time she received 607 shares of Lundy's Lane stock in exchange for 12,000 shares of Ingersoll-Rand Company stock, 3,600 shares of W. R. Grace and Company common stock and 3,040 shares of W. R. Grace and Company second preferred stock. All of the latter securities had been received by Janet Grace as gifts from the decedent at various times during the years 1917, 1918, 1919, and 1922. Of the 607 shares of Lundy's Lane Corporation stock originally owned by Janet Grace (which were all of the outstanding shares of the corporation at all times material to this litigation), Janet Grace made a gift of 200 shares to the decedent on March 31, 1929, and the decedent in turn made gifts totaling 100 shares to trusts for his five children (20 shares each) on April 4, 1930. On December 30, 1931, immediately prior to the creation of the Janet Grace trust, Janet Grace owned 407 shares of the stock of Lundy's Lane Corporation; and after the transfer of 40 shares to

that trust on December 30, 1931, the stock was held as follows:

	Shares
Janet Grace trust	40
Decedent	100
Five trusts for children (20 shares each)	100
Janet Grace	367
Total stock outstanding	607

(e) There is nothing in the evidence to indicate that Janet Grace, when she signed the instrument creating the Janet Grace trust and transferred property to that trust, was aware that the decedent had created the Joseph Grace trust.

13. The similarity between the trust instruments creating the Joseph Grace trust and the Janet Grace trust, as indicated in findings 11(a) and 12(a), also obtained with respect to the portions of the respective trust instruments which have been omitted from the findings.

14. At the time of the creation of the Janet Grace trust on December 30, 1931, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,633,113.26 on December 31, 1931, after the creation of the Janet Grace trust.

15. In connection with the creation of the Joseph Grace trust and the Janet Grace trust, neither the decedent nor Janet Grace had any desire to acquire property from the other. Instead, the motivation behind the creation of these trusts was the desire of the decedent to effect transfers of assets among, and for the benefit of, members of the family with a minimum of gift-tax consequences.

16. (a) Subsequent to the creation of the Joseph Grace trust on December 15, 1931, the decedent created trusts for the benefit of his children, as indicated in the following table:

Date of transfer	Property transferred	Beneficiary	Book value
12-28-35	$20,000.00 Gilchrest Realty Corp., 2½% Notes due April 1, 1921.	Maureen	$20,000.00
12-28-35	Two parcels of real property in Manhasset, Nassau Co., N.Y.; 112 sh. W. R. Grace & Co., Pref.; 238 sh. W. R. Grace & Co. Pref.	Maureen and Charles.	66,955.00
12-31-35	6 sh. Lundy's Lane Corp	Michael	83,258.46
12-2-37	100 sh. Ingersoll-Rand Co	Peter	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co	Michael	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co	Maureen	9,450.00
12-2-37	100 sh. Ingersoll-Rand Co	Charles	9,450.00
2-21-38	3% interest in real property situated at Northwest, Town of Easthampton, Suffolk Co., N.Y.	Maureen and Charles.	7,307.03
11-24-39	4,000 sh. Ingersoll-Rand Co	Maureen and Charles.	197,134.48

(b) In addition to creating the trusts referred to in paragraph (a) of this finding, the decedent subsequent to December 15, 1931, transferred assets directly to his children, as follows:

Date	Property transferred	Transferee	Book value
10-20-37	½ share Lundy's Lane Corp	Peter	$10,728.17
10-20-37	½ share Lundy's Lane Corp	Michael	
10-20-37	½ share Lundy's Lane Corp	Maureen	
10-20-37	½ share Lundy's Lane Corp	Charles	
9-11-39	225 sh. W. R. Grace & Co., Common	Peter	69,981.32
9-11-39	225 sh. W. R. Grace & Co., Common	Michael	
9-11-39	225 sh. W. R. Grace & Co., Common	Maureen	
9-11-39	225 sh. W. R. Grace & Co., Common	Charles	
11-24-39	2,000 sh. Ingersoll-Rand Co	Michael	197,134.48
11-24-39	2,000 sh. Ingersoll-Rand Co	Peter	
12-4-40	200 sh. Ingersoll-Rand Co	Peter	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Michael	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Maureen	3,400.00
12-4-40	200 sh. Ingersoll-Rand Co	Charles	3,400.00
12-24-40	250 sh. Ingersoll-Rand Co	Peter	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Michael	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Maureen	4,250.00
12-24-40	250 sh. Ingersoll-Rand Co	Charles	4,250.00
5-13-41	500 sh. Ingersoll-Rand Co	Peter's wife	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Michael	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Maureen	8,500.00
5-13-41	500 sh. Ingersoll-Rand Co	Charles	8,500.00
5-14-42	40 sh. Northern Ins. Co	Peter	6,400.00
5-14-42	40 sh. Northern Ins. Co	Michael	
5-14-42	40 sh. Northern Ins. Co	Maureen	
5-14-42	40 sh. Northern Ins. Co	Charles	
5-14-42	¼ int. Lakeville Vanhorn Prop	Peter	2,910.13
5-14-42	¼ int. Lakeville Vanhorn Prop	Michael	
5-14-42	¼ int. Lakeville Vanhorn Prop	Maureen	
5-14-42	¼ int. Lakeville Vanhorn Prop	Charles	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Peter	455.25
5-14-42	¼ int. Blakeley Valley Rd. Prop	Michael	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Maureen	
5-14-42	¼ int. Blakeley Valley Rd. Prop	Charles	

17. Subsequent to December 30, 1931, Janet Grace made transfers of assets as follows to or for the benefit of the decedent and their children:

Date	Book value	Description
4-27-32	$173,434.50	Gift to Joseph P. Grace, 150 shares Thomaston Corp., cap. stock.
12-28-35	180,268.89	Donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Maureen and Charles, 114 sh. W. R. Grace & Co., Pfd., stock, ½ interest in Providence Island Property, 38% interest in a certain $330,523.40 mortgage.
12-31-35	10,728.17	2 shares Lundy's Lane Corp. stock donated to J. P. Grace, Janet Grace, and J. P. Grace, Jr., as Trustees for Michael.
12-31-36	24,971.30	13,350 shares Grace Bros. & Co., Ltd., gifts to Joseph P. Grace and Janet Grace, as Trustees under instruments dated 8/26/20, 8/26/20, 1/15/25, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively, 3,339 each.
10-20-37	10,728.17	Gifts to each of four children of 2 shares, in all, of Lundy's Lane Corp.
12- 2-37	15,310.00	Gifts of 400 shares of National City Bank to Janet Grace and Joseph P. Grace, as Trustees of 4 trusts created 8/26/20, 8/26/20, 1/5/20, and 1/5/28, for the benefit of Peter, Michael, Maureen, and Charles, respectively (100 shares each).

18. (a) Janet Grace died on December 31, 1937, at the age of 53 years.

(b) At the time of her death, Janet Grace owned substantial properties. The capital account on her books showed a net worth at book value of $3,550,-131.04. Her gross estate (excluding the Janet Grace trust) was valued for Federal estate tax purposes at a total value of $5,550,481.78.

19. Janet Grace continued to act as one of the three trustees of the Janet Grace trust until her death. On January 13, 1938, the decedent, pursuant to a power vested in him under the terms of the trust instrument, appointed Joseph P. Grace, Jr., as successor trustee in the place and stead of Janet Grace, by reason of her death. By reason of the death of another of the original trustees, William R. Grace, on March 31, 1943, Daniel C. Keefe was appointed on May 20, 1943, as successor trustee in the place and stead of William R. Grace, and accepted the appointment on May 21, 1943. From the latter date until

the death of the decedent, William G. Holloway, Joseph P. Grace, Jr., and Daniel C. Keefe continued to act as trustees of the Janet Grace trust. The decedent was never a trustee of the Janet Grace trust.

20. (a) During the 6-year period between the creation of the Joseph Grace trust on December 15, 1931, and the death of Janet Grace on December 31, 1937, income from that trust in the amount of $72,908.45 was paid to Janet Grace pursuant to the terms of the Joseph Grace trust.

(b) At the time of Janet Grace's death, the Joseph Grace trust had on hand undistributed income in the amount of $60,719.28.

(c) A distribution of corpus having a book value of $173,434.50 was made to Janet Grace during her lifetime pursuant to the terms of the Joseph Grace trust.

21. (a) After the death of Janet Grace, her estate filed a Federal estate tax return, in which the Janet Grace trust was disclosed and reported as a nontaxable transfer by Janet Grace. Following an examination of the return by the Internal Revenue Service, the latter asserted a deficiency on the ground that the Joseph Grace trust and the Janet Grace trust were reciprocal. Negotiations were then conducted between representatives of the Internal Revenue Service and representatives of the estate of Janet Grace. During the course of these negotiations, the representatives of the estate countered the contention of the Internal Revenue Service by contending that the gross estate should be adjusted by (1) a reduction in the value, as shown on the return, of the shares of stock in Lundy's Lane Corporation owned by Janet Grace at the date of her death, (2) a reduction in the value, as shown on the return, of the shares of stock in W. R. Grace and Company owned by Janet

Grace at the date of her death, and (3) elimination from the assets shown on the return as Janet Grace's property of certain household effects which (according to representatives of the estate) belonged to the decedent. As a result of the negotiations, the Internal Revenue Service and the estate of Janet Grace entered into a compromise agreement whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate. This added $336,783.70 to the taxable estate of Janet Grace. As part of the compromise agreement, the estate of Janet Grace abandoned its counter-contentions, as summarized earlier in this finding.

(b) The compromise agreement referred to in paragraph (a) of this finding involved a reciprocal yielding of positions by both sides. The position yielded by the estate of Janet Grace approximated in monetary terms the position yielded by the Internal Revenue Service with respect to 45 percent of the value of the Janet Grace trust. Thus, the effect of the compromise agreement was to include the full appraised value of the corpus of the Janet Grace trust at the time of Janet Grace's death, or $612,334, as part of the taxable estate, and to adjust the valuations of other assets of the estate downward by 45 percent of the amount just stated.

(c) In discussing the issue as to the reciprocity of the Janet Grace trust and the Joseph Grace trust, as indicated in paragraph (a) of this finding, the negotiators believed that the value of the Janet Grace trust was less than the value of the Joseph Grace trust, and that if the doctrine of reciprocal trusts were applicable, it would be the value of the lesser trust, i.e., the Janet Grace trust, that would be taxable as part of the estate of Janet Grace.

22. The decedent died on July 15, 1950, at the age of 73 years.

23. During the period of approximately 18½ years that intervened between the creation of the Janet Grace trust on December 30, 1931, and the decedent's death on July 15, 1950, a total of $389,465.04 was paid to Joseph Grace pursuant to the terms of the Janet Grace trust.[12] In addition, as indicated in finding 12(c), the decedent had the use and enjoyment of Tullaroan as his family home until the time of his death.

24. (a) After the death of the decedent, a Federal estate tax return was filed on behalf of the decedent's estate. In this return, the transfers of assets by the decedent to the Joseph Grace trust were disclosed as transfers not includible in the gross estate, and the Janet Grace trust was reported as a trust under which the decedent held a limited power of appointment. Neither trust was included in the taxable gross estate of the decedent. The trust instruments creating the Joseph Grace trust and the Janet Grace trust were attached to the return as exhibits.

(b) Following an examination of the return referred to in paragraph (a) of this finding, the Internal Revenue Service (in addition to several relatively minor adjustments that are not involved in this litigation) added to the decedent's gross estate the sum of $1,116,888.62, with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives.

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[12] Of this total, the amount of $47,825.18 was distributable to the decedent during the lifetime of Janet Grace.

On the basis of this adjustment (and others that are not involved in this litigation), the Internal Revenue Service assessed an estate tax deficiency in the net amount of $363,500.97 against the decedent's estate.

(c) The deficiency of $363,500.97 mentioned in paragraph (b) of this finding, plus assessed interest in the amount of $55,720.08, or a total of $419,221.05 was paid by the decedent's estate on July 14, 1954.

25. Under the date of July 13, 1956, there was filed with the appropriate District Director of Internal Revenue, on behalf of the Estate of Joseph P. Grace, Deceased, a claim for "Refund of Taxes Illegally, Erroneously or Excessively Collected." The claim for refund stated in part as follows:

> Michael P. Grace, II, one of the executors of the Estate of Joseph P. Grace, Deceased (date of death July 15, 1950), is filing this claim for refund for and on behalf of said Estate. As a result of a tax examination of the U.S. Estate Tax return form 706 filed by the Estate of Joseph P. Grace, Deceased, an additional tax of $363,500.97 was assessed in 1954 and this entire amount was paid on July 14, 1954 together with interest of $55,720.05.
>
> The additional tax resulted from the fact that the Revenue Agent's Report in connection with the aforementioned examination increased the Estate's valuation by $1,116,888.62 which allegedly "represents reciprocal trust made by decedent's wife Janet on December 31, 1931 for the benefit of decedent." The R.A.R. stated that the aforestated amount was "includible in the gross estate under Section 811(C) of the Internal Revenue Code."
>
> This claim for refund is based on the contention that the aforestated trust was not a reciprocal trust and that same was not includible in the Estate of Joseph P. Grace under Section

811(C) or under any other Section of the Internal Revenue Code.

* * * * *

This claim is for the amount of $419,221.02 plus interest from July 14, 1954. * * *

26. The claim on which this suit is based, as set out in finding 25, had not been disallowed at the time when the petition was filed, and more than 6 months had elapsed since the filing of the claim. No part of the sum so claimed has been credited, refunded, or repaid.

27. The plaintiffs Michael P. Grace II, Joseph Peter Grace, Jr., and Charles MacDonald Grace are the duly qualified and acting executors of the decedent's estate, and as such are qualified to bring this suit.

28. This court has jurisdiction of the case.

29. The Joseph Grace trust and the Janet Grace trust ~~were not~~ created, and properties were not transferred to these trusts, pursuant to any agreement, express or implied, between the decedent and Janet Grace to make reciprocal transfers of properties.

30. The transfer of property by the decedent to the Joseph Grace trust was not in consideration of the transfer of property by Janet Grace to the Janet Grace trust; and the transfer of property by Janet Grace to the Janet Grace trust was not in consideration of the transfer of property by the decedent to the Joseph Grace trust.

31. In financial matters, Joseph P. Grace was very generous to his wife, Janet Grace. During the period 1911–1929, Mr. Grace transferred (or caused to be transferred) to Mrs. Grace real estate and securities of great value, as well as large amounts of cash (see findings 4, 6, and 7). Janet Grace had practically nothing in the way of wealth when she married

Joseph P. Grace, and as a result of his generosity, she ended up having approximately as much wealth as he did. Indeed, Mr. Grace's transfers of income-producing properties to Mrs. Grace were so extensive that ultimately he became worried over whether the income-producing properties still in his possession would be sufficient to defray the annual expenses for which he was responsible, amounting to at least $200,000 per year. Because of this worry, Mr. Grace had Mrs. Grace retransfer to him some securities that he had previously given to her. For example, on March 31, 1929, Mr. Grace had Mrs. Grace retransfer to him 200 shares of stock in the Lundy's Lane Corporation, having a book value of $613,444.32 (see finding 9). Notwithstanding such retransfers, Mrs. Grace still owned extremely valuable properties as the result of gifts originally received from Mr. Grace.

32. In his relations with his children, Joseph P. Grace was both generous and "trust minded" (see findings 8 and 16). He apparently was motivated by a desire to equalize benefits among the various children.

33. In establishing trusts for the benefit of his children, Joseph P. Grace dealt with J. Morden Murphy, head of the Customers Securities Department of W. R. Grace and Company. Mr. Grace would customarily tell Mr. Murphy for whose benefit he desired to create a trust and the assets that he desired to transfer to the trust. Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, would prepare the necessary papers to effectuate Mr. Grace's wishes, and Mr. Grace would sign them.

34. (e) At the time involved in the present litigation, both W. R. Grace and Company and the Grace National Bank were controlled by the Grace family,

of which Joseph P. Grace was generally considered to be the head. The two companies occupied the same building in New York City. Joseph P. Grace maintained his office in the same building.

(b) The Legal Department of W. R. Grace and Company provided legal services not only for that company but also for the Grace National Bank.

(c) The "securities cage" of the Grace National Bank handled the physical delivery and receipt of securities for the bank and for W. R. Grace and Company.

35. J. Morden Murphy was head of the Customers Securities Department of W. R. Grace and Company throughout the period 1930–1931. It was the principal function of that department to manage the securities and real estate of members of the Grace family, most of whom lived in the United States but some of whom lived in England. A great many trusts had been created for various members of the Grace family, and such trusts, together with the securities and real estate in them, were managed by the Customers Securities Department.

36. Alan Ross was employed in the Trust Department of the Grace National Bank throughout the period 1930–1931, and he became head of that department sometime during such period. The Trust Department of the bank did not have any connection with the trusts established for the benefit of members of the Grace family, or with any other aspects of the Grace family's affairs.

37. (a) Alan Ross was very active during the period 1930–1931 in attempting to generate and obtain trust business for the Grace National Bank. He approached many people with respect to the desirability of creating trusts and naming the Grace National Bank as trustee. As one of his promotional

activities, Mr. Ross endeavored to interest wealthy married couples of his acquaintance in a plan whereby a husband and wife would each set up a trust for the benefit of the other, each spouse receiving the income for life from the trust created for his or her benefit by the other spouse, and then, upon the death of a spouse-beneficiary, the property in the particular trust would pass to the children of the couple. If only one spouse in a husband-and-wife relationship was wealthy, it was part of Mr. Ross' plan that the wealthy spouse could transfer property directly to the other spouse, and the husband and wife could then create trusts for the benefit of each other in the manner previously mentioned.

(b) Mr. Ross pointed out to prospective customers that his plan could be utilized for the purpose of equalizing the family income between a husband and wife, and thus effecting annual savings in income taxes.

(c) Mr. Ross also expressed the view to prospective customers that his plan could be utilized to minimize estate taxes upon the deaths of the spouses, provided an adequate period of time—and Mr. Ross suggested at least a year—were permitted to elapse between the creation of the two trusts, so as to avoid a subsequent inference by the taxing authorities that the two trusts were created for the specific purpose of avoiding estate taxes.

38. Alan Ross' plan for husbands and wives in wealthy families to create trusts for the benefit of each other as a means of equalizing income and effecting annual savings in income taxes, and also of ultimately effecting savings in estate taxes if proper precautions were taken in timing the creation of the trusts, was known to, and discussed among, personnel of the Customers Securities Department of W. R.

Grace and Company (J. Morden Murphy and his assistant, Allen S. Rupley) and of the Legal Department of W. R. Grace and Company (Howard N. Deyo, Andrew B. Shea, and a Mr. Cogswell). Howard N. Deyo, head of the Legal Department, did not regard the plan as a sound device for minimizing taxes.

39. (a) Alan Ross suggested to Harold J. Roig that the latter and his wife execute trusts for the benefit of each other. Mr. Roig was an attorney and formerly had been head of the Legal Department of W. R. Grace and Company. In 1930–1931, Mr. Roig occupied an executive position in W. R. Grace and Company, and he also occupied an intimate and confidential relationship with Joseph P. Grace.

(b) Mr. Roig was not interested in Mr. Ross' plan.

40. Alan Ross endeavored to interest William Russell Grace, a brother of Joseph P. Grace, in Mr. Ross' plan for the creation of trusts by a husband and wife for the benefit of each other. William Russell Grace was not interested in the Ross plan.

41. (a) Sometime during the latter part of 1930, Alan Ross approached D. Stewart Iglehart, president of W. R. Grace and Company, and suggested that it might be advantageous if Mr. Iglehart and his wife were to create trusts for the benefit of each other.

(b) Mr. Ross suggested to Mr. Iglehart that the latter could possibly save some income taxes annually by splitting up his income-producing properties between himself and his wife, and then the two of them creating trusts for the benefit of each other. Mr. Ross also suggested to Mr. Iglehart that such a plan would result in savings on estate taxes if Mr. Iglehart first created a trust for the benefit of his wife and then Mrs. Iglehart waited for a reasonable length of time (Mr. Ross suggested at least a year) before creating a trust for the benefit of Mr. Iglehart, so that it would

not appear that the two trusts were created as part of a single plan to avoid the payment of estate taxes.

(c) Mr. Ross had a number of conferences with Mr. Iglehart, extending over a period of several months, in connection with Mr. Ross' suggestion that Mr. Iglehart and his wife create trusts for the benefit of each other. Mr. Iglehart was interested in the plan, but he had his own ideas concerning certain provisions which the trust instruments should contain. For example, Mr. Iglehart insisted that each trust instrument should contain a provision whereby the life beneficiary would have the power, at will, to withdraw all or any part of the principal of the trust at any time.

(d) As a result of the discussions mentioned in this finding, Mr. Iglehart asked Mr. Ross to draft proposed trust instruments in final form, so that Mr. Iglehart could examine them. A list of the assets that might be included in the two trusts was furnished to Mr. Ross by Mr. Iglehart's secretary, pursuant to instructions from Mr. Iglehart.

(e) In accordance with the authorization from Mr. Iglehart, Mr. Ross prepared final drafts of proposed trust instruments whereby Mr. Iglehart and his wife could create trusts for the benefit of each other. Mr. Ross then submitted the proposed trust instruments to Mr. Iglehart for consideration.

(f) A few days later, Mr. Ross found on his desk the two trust instruments that he had submitted to Mr. Iglehart. The document drafted by Mr. Ross for the creation of a trust by Mr. Iglehart for the benefit of his wife had been signed by Mr. Iglehart on February 9, 1931; and the document drafted by Mr. Ross for the creation of a trust by Mrs. Iglehart for the benefit of her husband had been signed on the same date, i.e., February 9, 1931. The execution of the two trust instruments on the same date was not in

accordance with the recommendation as to timing that Mr. Ross had previously made to Mr. Iglehart if savings in estate taxes were to be an objective.

42. D. Stewart Igelhart and Joseph P. Grace had been college classmates, and they were close personal friends. Mr. Grace had brought Mr. Iglehart into the Grace organization. In 1930–1931, Mr. Ilgehart was president of W. R. Grace and Company, and Joseph P. Grace was chairman of the board of that company.

43. Alan Ross never discussed the creation of trusts, or business matters of any kind, with Joseph P. Grace. Mr. Ross never met Janet Grace.

44. In some manner that is not shown by the evidence, Joseph P. Grace learned of Alan Ross' plan relative to the creation of trusts by a husband and wife for the benefit of each other. Sometime in 1931, Mr. Grace asked Harold J. Roig what he thought of Mr. Ross' idea respecting such trusts. Mr. Grace did not indicate that he was considering the creation of such trusts, and Mr. Roig did not understand that Mr. Grace was consulting him for legal advice. Mr. Roig responded to Mr. Grace's inquiry by indicating, in effect, that he had not done any legal research on the question, but that it was his "curbstone" opinion that Mr. Ross' plan would not be advantageous in so far as any prospective savings in estate taxes were concerned.

45. (a) With respect to the creation of the Joseph Grace trust of December 15, 1931 and the Janet Grace trust of December 30, 1931 (see findings 10, 11, and 12) there had been no prior consultation concerning any such plan by Mr. Grace with J. Morden Murphy when Mr. Grace, in early December of 1931, informed Mr. Murphy that he (Mr. Grace) wanted to have some trusts created by himself and Mrs.

Grace, and that Mr. Murphy should obtain and furnish to Mr. Grace the respective balance sheets of Mr. and Mrs. Grace, showing the assets held at the time by each of them, so that Mr. Grace might select the assets that were to be transferred to the respective trusts.

(b) Mr. Murphy obtained and furnished the two balance sheets to Mr. Grace. Mr. Grace examined the balance sheets, went down each list of assets, and selected the properties that were to be put into the two trusts.

(c) Mr. Grace indicated to Mr. Murphy that he wanted to put into the Joseph Grace trust all the properties of value which he still had and which were of such a nature that they would be suitable to be put in a trust for the lifetime of Mrs. Grace and then go to their children after Mrs. Grace's death.

(d) In connection with the creation of the Janet Grace trust, Mr. Grace selected Tullaroan, the family estate, to be put into that trust, and he also selected 40 shares of stock in the Lundy's Lane Corporation, indicating that the trust should have sufficient income-producing property to defray the taxes on Tullaroan.

(e) Mr. Grace did not make any statement to Mr. Murphy—or to anyone else, according to the evidence in the record—concerning the reason or reasons for the creation of the two trusts, although he indicated that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly in December 1931 because it was his view that a gift tax was "coming along any day now."

(f) It had previously been Mr. Grace's custom, in connection with the creation of trusts for the benefit of his children, to have Mr. Murphy, with the assistance of the Legal Department of W. R. Grace and Company, draft the necessary instruments to accom-

plish Mr. Grace's instructions. In connection with the creation of the Joseph Grace and the Janet Grace trusts of December 1931, however, Mr. Grace had in his possession, on the occasion of his first conference with Mr. Murphy, a draft of a trust instrument (or possibly drafts of two such instruments), which Mr. Grace gave to Mr. Murphy. Mr. Grace indicated to Mr. Murphy that the draft was to be used as a model in preparing the final versions of the instruments creating the Joseph Grace trust and the Janet Grace trust of December 1931. The draft was similar in several respects to the instruments creating the Iglehart trusts (see finding 41).

(g) In connection with the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, Mr. Grace did not indicate any desire to equalize the values of the properties that were to be put in the respective trusts. As a matter of fact, there was considerable uncertainty at the time concerning the true market values of the various properties that were transferred to the respective trusts. This was especially true with respect to Tullaroan, the family estate that was placed in the Janet Grace trust, and the pieces of real estate that were placed in the Joseph Grace trust. It was finally decided that, for the purpose of setting up books of account for the two trusts, approximate values would be assigned to Tullaroan and to the pieces of real estate that were put in the Joseph Grace trust, as it seemed unnecessary to make the considerable effort that would have been required to obtain accurate appraisals.

(h) After Joseph P. Grace had selected the various properties that were to be transferred to the Joseph Grace trust and the Janet Grace trust of December 1931, the final drafts of the documents creating those trusts were prepared in the Legal Department of

W. R. Grace and Company. It is inferred that this assignment was relayed to the Legal Department by J. Morden Murphy. The final drafts were modeled on the earlier draft which Mr. Grace had given to Mr. Murphy on the occasion of their first conference concerning the creation of the trusts, although certain changes were made by the Legal Department.

46. (a) During the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace concerning the includibility of certain property items in the estate tax return of the estate of Janet Grace (see finding 21), Joseph P. Grace attended a conference with Oscar M. Bate and Robert L. Loeb. Messrs. Bate and Loeb were members of the law firm of McFarlane & Munroe, which was representing the estate of Janet Grace and which also acted as counsel to Joseph P. Grace from time to time with respect to legal matters which Mr. Grace believed to be beyond the competency of the Legal Department of W. R. Grace and Company. At the conference, Mr. Bate, who was senior to Mr. Loeb in their law firm, informed Mr. Grace that the Internal Revenue Service was taking the position that the trusts created by Mr. Grace and his wife in December 1931 was reciprocal trusts and that, under fairly recent court decisions, one of the trusts was includable in the estate tax return of Janet Grace. Mr. Bate advised Mr. Grace that if the trusts were set up in consideration of each other, the law firm felt that one of the trusts was includable in the estate tax return of Janet Grace, but the firm did not know which one. Mr. Bate further stated that he thought the Internal Revenue Service could probably be persuaded to accept the view that the trust created by Mrs. Grace was the one taxable against her estate, and that this would be advantageous because, at the time of Mrs. Grace's death,

the assets in the Janet Grace trust had a considerably smaller value than the assets in the trust created by Mr. Grace.

(b) Mr. Grace, in effect, told Mr. Bate to go ahead and make the best settlement with the Internal Revenue Service that he could.

(c) Mr. Grace, at the conference, did not deny the reported contention by the Internal Revenue Service that the Joseph Grace trust and the Janet Grace trust of December 1931 were created in consideration of each other.

(d) As the result of the negotiations between the Internal Revenue Service and the estate of Janet Grace, a compromise agreement was entered into whereby 55 percent of the total appraised value of the corpus of the Janet Grace trust at the time of her death was included in her taxable estate, and the estate of Janet Grace abandoned the counter-contentions which the estate had asserted during the course of the negotiations, to the effect that certain shares of stock had been over-valued in the estate tax return and that certain household effects previously included in the estate tax return should be eliminated from it.

47. Following the payment of the deficiency and interest in the total amount of $419,221.05 by the estate of Joseph P. Grace on July 14, 1954 (see finding 24), Michael P. Grace, II, one of the sons of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, proposed to Joseph Peter Grace, Jr., and Charles MacDonald Grace, his two brothers and fellow executors, that a claim for refund be filed by the estate of Joseph P. Grace with the Internal Revenue Service.

48. (a) On June 27, 1956, Joseph Peter Grace, Jr., a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, conferred with his

attorney, Judge Burns, of the law firm of Burns, Currie, Maloney & Rice, with Francis Currie, a partner of Judge Burns, with Allen S. Rupley, who was then an official of W. R. Grace and Company, with Mr. Cogswell, of the Legal Department of W. R. Grace and Company, with Mr. Ray, who was then the senior trust officer of the Grace National Bank (the bank being part of the committee for Janet Maureen Grace), and with Robert L. Loeb, counsel for the estate of Janet Grace. The purpose of the conference was to determine whether Joseph Peter Grace, Jr., should join with Michael P. Grace, II, in filing a claim for refund on behalf of the estate of Joseph P. Grace.

(b) Francis Currie had previously conducted an investigation among personnel of W. R. Grace and Company and of the Grace National Bank in an effort to develop as much information as possible concerning the creation of the Joseph Grace trust and the Janet Grace trust of December 1931, and Mr. Currie disclosed to the conferees on June 27, 1956 the results of his investigation.

(c) Robert L. Loeb informed the conferees on June 27, 1956 concerning the conference that he had attended with Joseph P. Grace during the course of the negotiations between the Internal Revenue Service and the estate of Janet Grace (see finding 46). Mr. Loeb said to the conferees on June 27, 1956 that he thought Joseph P. Grace, at the earlier conference, recognized that the two trusts were factually reciprocal, that Mr. Grace did not wish to litigate the issue, and that Mr. Grace wanted to make a settlement.

(d) On the basis of the discussion at the conference on June 27, 1956, Joseph Peter Grace, Jr., instructed his attorney not to join in a claim for refund.

49. (a) On July 9, 1956, Charles MacDonald Grace, a son of Joseph P. Grace and one of the executors of the estate of Joseph P. Grace, attended a conference with his attorney, Judge Burns, with Francis Currie, and with Mr. McDevitt. The other conferees informed Charles MacDonald Grace of the decision previously made by Joseph Peter Grace, Jr., not to join in a claim for refund (see finding 481), and they advised Charles MacDonald Grace that he should also decline to join in such a claim.

(b) In accordance with the advice received by him, Charles MacDonald Grace said at the conference on July 9, 1956 that he would not join in a claim for refund.

50. On August 2, 1956, Francis Currie wrote a letter to Morris W. Primoff, attorney for Michael P. Grace, II, and stated in part as follows:

> I am authorized to say that Messrs. Peter and Charles Grace are completely satisfied that the available evidence will not sustain the burden of proof to support the claims for refund filed by Mr. Michael Grace. On the contrary, all available evidence indicates that the trusts in question were specifically intended to be reciprocal, in order to avoid gift taxes which became effective on January 1, 1932, and to avoid estate taxes through a method generally regarded as available prior to the decision in the Lehman case. In the light of this evidence of which they are aware, Messrs. Peter and Charles Grace cannot join in the claims for refund filed by Mr. Michael Grace.
>
> Messrs. Peter and Charles Grace have reached this conclusion reluctantly, in view of their personal interests in any refund which might be recovered. The share of Mr. Charles Grace in the amount of federal estate tax and interest which might be recovered if the claim for refund were allowed would be almost $40,-

000; the share of Mr. Peter Grace would be over $235,000, considerably larger than the share of Mr. Michael Grace.

I am also authorized to say that Grace National Bank of New York, as a member of the Committee for the Property of Janet Maureen Grace, concurs in the decision of Messrs. Peter and Charles Grace not to join in the claim for refund.

51. (a) The original petition in the present action was filed on September 24, 1959 by Michael P. Grace, II, as an executor of the estate of Joseph P. Grace, deceased.

(b) After the filing of the original petition, the attorney for Michael P. Grace, II, represented to Joseph Peter Grace, Jr., and Charles MacDonald Grace that the claim asserted in the petition might be denied by the court on the ground of defective parties plaintiff. At the request of the attorney for Michael P. Grace, II, and because Joseph Peter Grace, Jr., and Charles MacDonald Grace did not wish to forfeit any money that they might be entitled to receive, Joseph Peter Grace, Jr., and Charles MacDonald Grace decided to join in the prosecution of the case before the Court of Claims.

(c) On August 2, 1963, the first amended petition was filed in the present action by the estate of Joseph P. Grace, deceased, and by Michael P. Grace, II, Joseph Peter Grace, Jr., and Charles MacDonald Grace, executors.

52. The evidence in the record does not indicate that Joseph P. Grace was motivated by the desire to avoid or lessen estate taxes in the setting up of the Joseph Grace trust and the Janet Grace trust in December 1931.

53a. The Joseph Grace trust and the Janet Grace trust were created by, or at the instigation of, Joseph

P. Grace as parts of what was essentially a single transaction.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiffs are entitled to recover, and judgment is entered to that effect. The amount of recovery will be determined pursuant to Rule 47(c).

In the United States Court of Claims

No. 400-59

Estate of Joseph P. Grace, Deceased, et al.

v.

The United States

ORDER

On April 19, 1968, the court rendered an opinion holding that the plaintiffs were entitled to recover and entering judgment to that effect. The determination of the amount of the recovery was reserved pending further proceedings pursuant to Rule 47(c).

On June 24, 1968, the commissioner of this court filed a memorandum report recommending that, in accordance with the opinion of the court and the stipulation of the parties, judgment be entered for the plaintiffs in the sum of $419,221.05, together with interest thereon from July 14, 1954, as provided by law, which recommendation is adopted by the court.

It Is Therefore Ordered that judgment be and the same is entered for the plaintiffs in the sum of four hundred nineteen thousand two hundred twenty-one dollars and five cents ($419,221.05), together with interest thereon from July 14, 1954, as provided by law.

By the Court:

______________,

Chief Judge.

D

In the United States Court of Claims

No. 400-59

ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS

v,

THE UNITED STATES; JANET MAUREEN GRACE, BY MICHAEL P. GRACE, II, AND MICHAEL P. GRACE, II, INDIVIDUALLY, INTERVENORS

ORDER

This case comes before the court on its own motion to amend the caption set forth on and in the order entered herein on June 28, 1968. Upon consideration thereof

IT IS ORDERED that the part of the caption in the order of June 28, 1968, designating the plaintiffs as "ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL" be and the same is stricken and deleted and in lieu thereof shall be inserted as plaintiffs the caption "ESTATE OF JOSEPH P. GRACE, DECEASED, MICHAEL P. GRACE, II, JOSEPH PETER GRACE, JR., AND CHARLES MACDONALD GRACE, EXECUTORS."

By the Court:

———— ————,

Chief Judge.

No. 574

In the

Supreme Court of the United States

OCTOBER TERM, 1968

UNITED STATES,
Petitioner,

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Claims

BRIEF IN OPPOSITION FOR RESPONDENTS

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No. 574

In the

Supreme Court of the United States

OCTOBER TERM, 1968

UNITED STATES,
Petitioner,

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Claims

---

BRIEF IN OPPOSITION FOR RESPONDENTS

Respondents pray that the writ of certiorari to review the judgment entered by the United States Court of Claims on April 19, 1968, applied for in the petition filed in this Court on September 26, 1968, by the Solicitor General on behalf of the United States, be denied for the reasons hereinafter set forth.

OPINION BELOW

The opinion and judgment entered by the Court of Claims on April 19, 1968, are reported at 393 F. 2d 939, 21 A.F.T.R. 2d 1952 and 68-1 U.S.T.C ¶ 12,521, and are set forth in the appendix to the petition (App. 1a-68a.)

JURISDICTION

Regretably, the Solicitor General, in his petition, has failed to state in a candid and truthful manner the facts with reference to the date of the judgment or decree sought to be reviewed, and the time of its entry. Accordingly, it is necessary to restate the true facts as follows:

> The judgment of the Court of Claims comprised within its opinion, findings of fact and conclusions of law (App. 1a-68a), which the petition seeks to bring before this Court for review by writ of certiorari, was entered on April 19, 1968. A subsequent order entered on June 28, 1968, pursuant to stipulation of the parties, merely confirmed the amount of the recovery as previously indicated in the opinion and set forth in the findings of fact which had been made a part of the judgment previously entered on April 19, 1968. A further order was entered on July 3, 1968, amending the caption of the order of June 28, 1968, to include the names of the three individual executors as set forth in the caption of the original judgment of April 19, 1968.

The jurisdictional facts are more fully stated below.

It is the practice of the Court of Claims to formally announce and publish its ultimate decisions in all cases at a special session of the Court, known as "announcement day", held on one day of each month while the Court is in session.

At such an announcement day held on April 19, 1968, the Court of Claims formally rendered and published its final decision in this case, consisting of a fifty-five page pamphlet printed by the Government Printing Office, comprising a per curiam opinion, dissenting opinion, findings of fact and conclusion of law. This decision, as originally printed and published by the Court of Claims[1], prominently displayed, immediately below the name of the court and docket number and above the title of the case, the following inscription:

"(Decided April 19, 1968)"

This formal decision finally culminated nine years of litigation, throughout the entire course of which there had been no doubt, question or uncertainty with respect to the amount of recovery to which the respondents would be en-

[1] The version of the Court of Claims decision presented in the appendix to the petition contains a substantially altered and rearranged form and style of heading (App. 1a) as compared with the genuine printed decision of the lower court. Although the prominent inscription "Decided April 19, 1968" has been omitted, the date is submerged in a subordinate position less likely to be observed. In a more subtle attempt at deception, the headline "In the United States Court of Claims", which appeared in large, fancy black-letter type at the head of the decision as originally published by the court, has been omitted from the heading of the decision as it appears in the appendix to the petition. Yet, this same headline in large, fancy black-letter type identical in size and style to that actually appearing at the head of the formal printed decision of April 19, 1968, has been inserted at the head of the two subsequent informal typewritten orders as reproduced on pages 69a and 71a of the appendix; also, the *dates* affixed with rubber stamps on each of these subsequent orders have been omitted from the reproductions on pages 69a and 71a of the appendix. Actually, the genuine orders dated June 28, 1968, (App. 69a) and July 3, 1968 (App. 71a) including the headings thereof were wholly typewritten, except for the dates stamped thereon. While we do not wish to quarrel over the choice of type size and style, we submit that this substitution of headings and omission of dates appears deliberately designed to dissemble the true nature of the lower court's formal decision and subsequent orders, respectively, and to mislead this Court concerning the date of entry of the judgment sought to be reviewed.

titled in the event of a decision that the trust in question was not taxable as part of the decedent's gross estate.

The per curiam opinion contained in the decision rendered by the Court of Claims on April 19, 1968, expressly declared:

> "* * * The court is also in agreement with the opinions of the trial commissioner, as modified and combined into a single opinion, and hereby adopts the same, together with his findings of fact, *as the basis for its judgment* in this case. Therefore, plaintiffs are entitled to recover and judgment is entered to that effect with the amount of recovery to be determined pursuant to Rule 47 (c)." (App. 2a, emphasis added).

The conclusion of law included in this decision of April 19, 1968, stated:

> "Upon the foregoing findings of fact, which are *made a part of the judgment herein*, the court concludes as a matter of law that the plaintiffs are entitled to recover, and *judgment is entered* to that effect. The amount of recovery will be determined pursuant to Rule 47 (c)." (App. 68a, emphasis added)

On the same day, the clerk of the Court of Claims made the following entry on page eight of the court's official docket record of this case:

> APR 19 1968 Judgment for plaintiff with the amount of recovery to be determined by further proceedings. (pursuant to Rule 47 (c)). Opinion Per Curiam Dissenting opinion by Judge Davis in which Judge Nichols joins."

Rule 47 (c) of the Court of Claims rules, expressly referred to in the aforesaid judgment entered on April 19, 1968, prescribes that, where the court reserves determination of the

amount of recovery upon entering judgment that a party is entitled to recover; "in such event, the judgment on the question of the right to recover *shall be final*, subject to proceedings had under Rules 68 and 69." (Rules 68 and 69 pertain to motions for rehearing; no such motion for rehearing was filed by respondent).

Notwithstanding that the judgment entered on April 19, 1968, specified that the amount of recovery was to be determined pursuant to Rule 47 (c), the amount of recovery was clearly indicated in the opinion rendered by the court on April 19, 1968, "as the basis for its judgment in this case," and in the findings of fact which were "made a part of the judgment herein". The opinion set out that the question to be decided was whether the Internal Revenue Service acted correctly in adding to the gross estate of the decedent the sum of $1,116,888.62, representing the value of a trust created on December 30, 1931 (App. 2a), that the addition of this sum to the decedent's gross estate had resulted in the assessment of an estate tax deficiency in the net amount of $363,500.97 plus assessed interest of $55,720.08, which amounts (totaling $419,221.05) were paid by the decedent's estate on July 14, 1954 (App. 12a - 13a), that the trust in question should not be included in the estate of the decedent, and accordingly, plaintiffs are entitled to recover (App. 19a).

All of these details with respect to payment by the decedent's estate on July 14, 1954 of the net estate tax defi-

ciency and assessed interest thereon, totaling $419,221.05, as a result of the inclusion in the taxable estate of the trust property adjudged to have been wrongfully so included, were also set forth in the findings of fact. (Findings 24 (b) and (c) and 25, App. 52a - 54a; see, also, Finding 47, App. 64a), which were expressly "made a part of the judgment herein" (App. 68a), in the judgment of April 19, 1968.

Subsequently, on June 28, 1968, the court made an informal typewritten order (App. 69a) entering judgment for the plaintiffs in the sum of $419,221.05, being exactly the same amount specified in the prior decision of April 19, 1968, together with interest thereon from July 14, 1954, being the date of payment indicated in the prior decision of April 19, 1968. This subsequent order of June 28, 1968, was made pursuant to a memorandum report of the trial commissioner recommending that judgment be entered for such amount "*in accordance with the opinion of the court* and the stipulation of the parties." It was but a technical formality confirming the amount of the judgment of April 19, as indicated by the opinion on which that judgment was based and the findings of fact which were made a part of it. The amount of the wrongful assessment to be refunded, and the date of payment thereof from which interest is to be computed as provided by law, had been specified in the claim for refund filed July 13, 1956, on which this suit was based (Finding 25, App. 53a - 54a), had been alleged and admitted in the pleadings, had been set forth in findings of fact submitted in the first report of the trial commissioner filed July 20, 1964, and not excepted to by either party, set forth by the court in its

formal opinion and findings of fact made part of its judgment of April 19, 1968, and stipulated by the parties in a stipulation filed in the Court of Claims on June 12, 1968. This amount and date had at all times been known to and agreed upon by the parties and had never been subject to any question, doubt or uncertainty.

Thereafter, on July 3, 1968, the court entered a further informal typewritten order amending the caption of the order dated June 28, 1968, by expanding the designation of the plaintiffs to include, after the name of the decedent's estate, the names of the individual executors, in lieu of "ET AL". This order, like the order dated June 28, was merely confirmatory of the court's formal decision of April 19, the caption of which had similarly included the names of the individual executors. The names of these individual executors and their status as plaintiffs had also been set forth in the findings of fact which were made a part of the judgment entered on April 19 (See Finding 27, App. 54a). Thus, the order of July 3, like the June 28 order, was merely confirmatory of the judgment entered by the court on April 19.

The petitioner filed its petition for a writ of certiorari herein on September 26, 1968, the 160th day after entry of the judgment on April 19, 1968. Section 2101 (c) of the Judicial Code (28 U.S.C. § 2101 (c)) prescribes that "* * * any writ of certiorari intended to bring any judgment or decree in a civil action, suit or proceedings before the Supreme Court for review shall be taken or applied for within ninety days after the entry of such judgment or decree." The last phrase, "*such* judgment or decree", obviously refers back

to the *same* judgment or decree which the writ of certiorari is "intended to bring * * * before the Supreme Court for review".

It is obvious from a perusal of the petition that the writ of certiorari applied for therein is intended solely to bring before the Supreme Court for review the judgment and decision entered by the Court of Claims on April 19, 1968. The petition was not filed within ninety days after the entry of that judgment, nor within any extension of such time granted by this Court as required by the statute to invoke the jurisdiction of the Supreme Court.

In *Federal Trade Commission v. Minneapolis-Honeywell Regulator Company*, 344 U.S. 206, 97 L. ed., 245, 72 S. Ct. 245, it is held (344 U.S. at pp. 211-213):

> "Thus, the mere fact that a judgment previously entered has been reentered or revised in an immaterial way does not toll the time within which review must be sought. *Only when the lower court changes matters of substance, or resolves a genuine ambiguity, in a judgment previously rendered should the period within which an appeal must be taken or a petition for certiorari filed begin to run anew.* The test is a practical one. The question is whether the lower court, in its second order, has disturbed or revised legal rights and obligations which, by it prior judgment, had been plainly and properly settled with finality.
>
> The judgment of September 18, which petitioner now seeks to have us review, does not meet this test. It reiterated without change, everything which had been decided on July 5. Since the one controversy between the parties related only to the matters which had been adjudicated on July 5, we cannot ascribe any signif-

icance, as far as timeliness is concerned, to the later judgment.

* * * * *

"It is a principal reflected in the statutes which limit our appellate jurisdiction to those cases where review is sought within a prescribed period. Those statutes are not to be applied so as to permit a tolling of their time limitations because some event occurred in the lower court after judgment was rendered which is of no import to the matters to be dealt with on review." (Emphasis supplied).

Measured by these standards, the time for filing a petition for a writ of certiorari to review the judgment entered by the Court of Claims on April 19, 1968, began to run on that date, and the petition filed 160 days thereafter is not timely. Manifestly, the subsequent order of June 28, fixing the amount of recovery and date from which interest should be computed, "is of no import to the matters to be dealt with on review". The petition does not in any way question or refer to either of the subsequent orders dated June 28 and July 3, but is addressed exclusively to the judgment entered on April 19, 1968. Indeed, in its statement of the case, the petition recites the amount of the deficiency to be recovered (as confirmed by the order of June 28, 1968) as one of the undisputed facts of the case, citing in support thereof only findings which were a part of the judgment entered on April 19, 1968 (see first full sentence beginning on page 5 of the petition). Thus, it is clear on the face of the petition itself that the order of June 28 is in no way relevant to the matters to be dealt with upon review, and that the amount of recovery confirmed therein was ade-

quately determined by the findings made part of the judgment entered on April 19.

The Court of Claims was without power to extend the jurisdictional time limit within which the respondents must apply for a writ of certiorari in order to invoke the jurisdiction of this Court. It should not be assumed that the judges of the Court of Claims employed the procedure of subsequently confirming the amount of recovery under Rule 47 (c) as a device to grant the petitioner a 70-day extension of the jurisdictional time limit within which to file its petition in this Court for a writ of certiorari to review the judgment entered April 19, 1968, which they had no power to do overtly; nor should the formal decision and judgment rendered and entered by the Court of Claims on April 19, 1968, be regarded as merely an "empty form". Cf. *United States v. Hark*, 320 U.S. 531, 535, 88 L. ed. 290, 295.

Nor does there appear to be any reason in equity or fairness why the statutory time limit should be mitigated in this case. All matters that might conceivably affect the petitioner's decision whether to petition this Court for a writ of certiorari to review the judgment, or that might in any way affect the preparation or manner of presentation of its petition, were clearly spelled out in the judgment entered by the Court of Claims on April 19, 1968. Upon reading that decision, the petitioner was fully advised of every detail pertinent to its application for a writ of certiorari, including the details confirmed by the subsidiary orders of June 28 and July 3. At all times from and after the entry of judgment on April 19, the amount of recovery was known to the

respondent with sufficient certainty that it could have issued a check in full satisfaction of the judgment had it so desired, or could have prepared and filed its petition for a writ of certiorari without awaiting any further orders from the Court of Claims. That it was not necessary for the petitioner to await entry of the order of June 28 in order to ascertain the amount of recovery is especially clear in view of the fact that this amount was routinely stipulated by the parties in a stipulation filed with the Court of Claims on June 12, 1968, more than 90 days prior to filing of the petition. That stipulation stated:

> "It is hereby stipulated and agreed that the amount of judgment to be entered in favor of plaintiffs in accordance with Rule 47 (c) *pursuant to the decision of the court on April 19, 1968*, for the sum of Four Hundred Nineteen Thousand Two Hundred Twenty-One and 05/100ths ($419,221.05) Dollars * * * plus interest on the said sum * * * as provided by law from the date of payment, July 14, 1954." (Emphasis supplied).

As indicated by the stipulation, the amount of recovery was ascertained "pursuant to the decision of the court on April 19, 1968", and was not dependent upon any further proceedings or subsequent determination. Under these circumstances, the entry of the subsequent order on June 28, 1968, was obviously but a technical formality that had no practical or legal significance that would justify allowing the petitioner to delay the filing of its petition until 70 days beyond the expiration of the ninety-day period normally allowed.

Section 2101 (c) of the Judicial Code, 28 U.S.C. § 2101 (c), permits the time limit to be extended for a period not exceeding 60 days only by "A justice of the Supreme Court, for good cause shown," and clearly does not contemplate that the Court of Claims be empowered to extend the time limit for indefinitely prolonged periods by resorting to Rule 47 (c) or by any other device. When, as in this case, the Court of Claims chooses to employ its Rule 47 (c) as a convenient expedient to leave subject to subsequent confirmation an amount of recovery plainly set forth in its formal decision and judgment, to treat the subsequent confirmatory order as tolling the time limit would, in effect, empower the Court of Claims to grant an extention of time to the losing party within which to apply to this Court for review of a final judgment. Moreover, such a tolling of the time limit in these circumstances would enable the losing party to gain additional time and prolonged delay in filing its petition for a writ of certiorari simply by delaying the execution and entry of a routine stipulation, or refusing to stipulate uncontested matters on frivolous grounds.

Since the writ of certiorari intended to bring the judgment entered by the Court of Claims on April 19, 1968, before the Supreme Court for review was not applied for within 90 days after the entry of such judgment, this Court lacks jurisdiction to grant the writ of certiorari applied for in the petition filed on September 26, 1968. Accordingly, the petition for a writ of certiorari should be denied.

QUESTIONS PRESENTED

1. Whether this Court lacks jurisdiction to grant a writ of certiorari intended to bring before the Supreme Court for review a judgment entered by the Court of Claims on April 19, 1968, when such writ was not applied for until September 26, 1968, the 160th day after the entry of such judgment.

2. Whether the Court of Claims, in its decision rendered April 19, 1968, correctly interpreted § 811 (c) (1) (B) of the Internal Revenue Code of 1939, in the light of the judicially-developed "reciprocal trust doctrine", as applied to the complex and unique facts and circumstances presented in this particular case.

STATUTES INVOLVED

Section 2101 (c) of the Judicial Code (28 U.S.C. § 2101 (c)):

"(c) Any other appeal or any writ of certiorari intended to bring any judgment or decree in a civil action, suit or proceeding before the Supreme Court for review shall be taken or applied for within 90 days after entry of such judgment or decree. A justice of the Supreme Court, for good cause shown, may extend the time for applying for a writ of certiorari for a period not exceeding 60 days.'

Section 811 of the Internal Revenue Code of 1939 (U.S.C. 1939 Code, § 811):

"SEC. 811. GROSS ESTATE.

"The value of the gross estate of the decedent shall be determined by including the value of all property,

real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

"(c) * * * (1) GENERAL RULE.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth,) by trust or otherwise—

* * * * *

"(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

* * * * *

"Subparagraph (B) shall not apply to a transfer made before March 3, 1931; nor shall subparagraph (B) apply to a transfer made after March 3, 1931, and before June 7, 1932, unless the property transferred would have been includable in the decedent's gross estate by reason of the amendatory language of the joint resolution of March 3, 1931 (46 Stat. 1516).

* * * * *

"(d) * * * (2) TRANSFERS ON OR PRIOR TO JUNE 22, 1936—To the extent of any interest therein of which the descedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case

of a bona fide sale for an adequate and full consideration in money or money's worth. * * * "

Joint Resolution of March 3, 1931, C. 454, 46 Stat. 1516 (made applicable by the last sentence of subsection 811 (c) (1), above):

"RESOLVED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED, That the first sentence of subdivision (c) of Section 302 of the Revenue Act of 1926 is amended to read as follows:

"(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, including a transfer under which the transferor has retained for his life or any period not ending before his death:

(1) The possession or enjoyment of, or the income from, the property, or

(2) The right to designate the persons who shall possess or enjoy the property or the income therefrom,

except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

STATEMENT

The facts material to consideration of the question presented by the petition are concisely stated in the findings of fact made part of the judgment entered by the Court of Claims on April 19, 1968, which are set forth in the appendix to the petition (App. 32a - 68a).

The petitioner, on July 14, 1954, collected from the respondents, as executors of the estate of Joseph P. Grace (hereinafter called "the decedent"), who died on July 15, 1950, the sum of $419,221.05 as a deficiency in estate tax and interest thereon, based upon a determination that the value of assets of a trust (hereinafter called the Janet Grace Trust) which the decedent's wife, Janet Grace, created on December 30, 1931, and of which her husband, the decedent, was the beneficiary for his lifetime, was includable under Section 811 (c) of the Internal Revenue Code of 1939. Respondents claimed this deficiency assessment to be wrongful, and brought suit for refund.

Upon the death of the lifetime beneficiary of a trust, Section 811 (c) (1) (B) in plain and explicit terms authorizes inclusion of the trust property in his taxable gross estate only if and "to the extent" that such life beneficiary is also the transferor who "made a transfer * * * under which he retained" the life benefits. With equal clarity, the statute excludes from the taxable gross estate of the life beneficiary property in which he had a life estate given to him under a transfer made by another person for his benefit. To be taxable under Section 811 (c) (1) (B), the decedent must have been not merely lifetime beneficiary but also the settlor who created the trust and transferred his own property to the trust for his own benefit. In the present case, the statutory question is simply whether the facts of the case disclose that the decedent was, in reality, the "grantor", "settlor" or "transferor" who made a transfer of his own property to the Janet Grace trust.

"It is well established that the person who furnishes the consideration for the creation of a trust is the settlor even though in form the trust is created by another." *Blackman v. U. S.* (1943), 98 Ct. Cl. 413, 48 F. Supp. 362; *Lehman v. Commissioner* (2nd Cir. 1940), 109 F. 2d 99, cert. den. 310 U.S. 637. The undisputed facts are that the Janet Grace trust was created by the decedent's wife on December 30, 1931 (Finding 12 (a), App. 43a), at which time she transferred to herself and two others as trustees the family homestead known as "Tullaroan" and 40 shares of stock in a personal holding company known as Lundy's Lane Corporation (Finding 12 (b), App. 45a-46a). Janet Grace had owned the Tullaroan property since 1911 (Finding 6 (b), App. 34a). She had owned the Lundy's Lane stock since that corporation was incorporated in 1923 to hold securities belonging to her, which she had acquired as gifts from the decedent at verious times from 1917 to 1922 (Finding 12 (d), App. 46a). Thus, for many years prior to the creation of the Janet Grace trust, the Tullaroan property and 40 shares of stock had belonged exclusively to Janet Grace; it was she who "made a transfer" of those properties to the Janet Grace trust; and it was she who "furnished the consideration" for the trust. The decedent had not at any time made a transfer of any of his property to the Janet Grace trust.

The petitioner, while not disputing those facts, contended in the court below that the Janet Grace trust was made in consideration of a trust (herein called the Joseph Grace trust) that the decedent had created on December 15, 1931,

fifteen days before the Janet Grace trust had been created. After the first trial of the case in 1963, the trial commissioner made findings of fact, which were ultimately adopted by the court (Findings 1 through 30, inclusive, App. 32a - 54a) in which the facts were found to be, *inter alia*, as follows (App. 54a):

> "29. The Joseph Grace trust and the Janet Grace trust were not created, and properties were not transferred to these trusts, pursuant to any agreement, express or implied, between the decedent and Janet Grace to make reciprocal transfers of properties.
>
> "30. The transfer of property by the decedent to the Joseph Grace trust was not in consideration of the transfer of property by Janet Grace to the Janet Grace trust; and the transfer of property by Janet Grace to the Joseph Grace trust was not in consideration of the transfer of property by the decedent to the Joseph Grace trust."

Upon examination of the evidence and review of the findings, after study of printed briefs and exceptions submitted by both parties, and after oral arguments presented at a formal hearing before the five judges of the court sitting *en banc*, the court evidently agreed with these findings. That, in our view, should have adequately disposed of the case. But the petitioner, being unable to offer any serious challenge to such findings, argued vehemently on brief and in oral argument that the trusts should be assumed to have been created as a scheme or device to avoid estate taxes, based on its assertion that certain inadmissible matter not offered as evidence and witnesses not called to testify would have so indicated. Although the petitioner had not asked for a retrial, a majority of the judges[2] decided to give the petitioner

[2] Chief Judge Cowen dissented from the remand order, and Judge Collins dissented from the denial of a motion for rehearing on same.

another bite out of the apple, and entered an order on March 25, 1966, remanding the case to the trial commissioner "for a further hearing at which both parties may present further evidence as to whether the decedent was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid or lessen estate taxes," and directing that the inadmissible matter be considered. After a re-trial in which even privileged communications between the decedent and his attorneys and an unsigned hearsay memorandum were admitted as evidence, and after briefs to the commissioner and an exhaustive analysis of the evidence, the trial commissioner proposed additional findings of fact which were ultimately adopted by the court (Findings 31 through 53, inclusive, App. 54a - 68a) after the filing of lengthy briefs, exceptions and oral arguments, examination and review by the court of the evidence and findings. After re-trial and rehearing the facts with reference to "tax-avoidance" were found to be as follows (Finding 52, App. 67a):

> "52. The evidence in the record does not indicate that Joseph P. Grace was motivated by the desire to avoid or lessen estate taxes in the setting up of the Joseph Grace trust and the Janet Grace trust in December 1931."

In this connection, the court, in its opinion, commented that the findings are "amply supported by the record" (App. 1a) and stated, with reference to the "tax-avoidance" assertion:

> "It appears from the evidence in the augmented record that Joseph P. Grace never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust on December 15, 1931,

and caused his wife to create the Janet Grace trust on December 30, 1931. The evidence also establishes other logical and even compelling motives for these transactions. (App. 16a)

* * * * * *

"The reasonable inference to be drawn from the record as a whole is that Joseph P. Grace was not motivated by a purpose to minimize taxes of any kind in originally deciding to create the Joseph Grace trust and to have his wife create the Janet Grace trust, although Mr. Grace did mention that, from the standpoint of timing, he desired that the creation of the trusts be accomplished promptly in December 1931, because it was his view that a gift tax was 'coming along any day now.'

* * * * *

"It has been shown that the two trusts were not created to avoid estate taxes but merely as another step in a long-established pattern of family giving." (App. 19a)

The respondent was thus defeated in the lower court because its factual assertions were proven wrong by the evidence and its legal arguments were squarely at odds with the statutory basis of liability and the previously decided cases and founded upon factual premises that were clearly disproven by the established facts as found by the court. Being disgruntled by this defeat, the petitioner applies for review asking, essentially, that this Court adopt the respondent's version of the facts, and extend the "reciprocal trust doctrine" in an amorphous manner to indulge in the fictitious pretense that the decedent, instead of his wife, was the transferor who "made a transfer" of his wife's property to the Janet Grace trust, so as to hold it taxable to his estate.

REASONS FOR DENIAL OF WRIT

1. There is no conflict among the decisions of lower courts with respect to the single issue of law involved in this case.

The sole issue involved in this case is whether the "reciprocal trust doctrine", sometimes referred to as the *Lehman* doctrine, should be applied so as to treat the decedent, rather than his wife, as the transferor who "made a transfer" to the Janet Grace trust "under which he retained" the life estate therein granted to him.

That doctrine is a judicial concept which has been rationally developed and uniformly applied by the lower courts without the intervention of this Court. It is based upon the principle that "A person who furnishes the consideration for a trust is the settlor, even though in form the trust is created by another". *Lehman v. Commissioner*[2] (2nd Cir., 1940) 109 F. 2d 99, cert. den. 310 U.S. 637. It holds that when one settlor creates a trust for the benefit of another, *in consideration for* the creation of a similar trust for his own benefit by that other person, then the respective settlors will be interchanged for tax purposes so as to treat each as the settlor of the trust for his own benefit. It is the

[2] Petitioner, by a significant omission that changes the meaning of the sentence, misquotes the Lehman case on page 9 of the petition. The omitted material is indicated in italics below:

> The decisive point is that the decedent *by transfer of his share to the brother or for the brother's use or according to the brother's direction* caused the brother to make a transfer of property in trust under which the decedent had the right to withdraw $150,000 from principal * * *. (109 F. 2d 100, italics indicate words omitted in petition).

Thus, it was not the fact that the *decedent* "caused" his brother to make the trust, but that he did so *by transfer of his share to the brother,* whereby he furnished a consideration or quid pro quo, that resulted in reciprocal taxation.

furnishing of a consideration, or *quid pro quo*, for the transfer in trust that brings the doctrine into play and constitutes the person who transferred the consideration as the taxable party deemed to have "made a transfer * * * under which he has retained * * *" the rights to which he is entitled under the trust. In terms of Section 811 (c) (1) (B), the consideration transferred by the decedent is deemed to be the "property * * * of which the decedent has at any time made a transfer", which is to be included in his estate.

As explained in *Estate of Moreno v. Commissioner* (8th Cir., 1958), 260 F. 2d 389, 390:

> "The question of whether the doctrine of the Lehman case can be applied—whether the trusts are crossed or reciprocal trusts—is one of fact. It is simply a question whether one trust was made in consideration of the other."

This simple factual test has been unanimously and uniformly applied in all of the cases dealing with allegedly reciprocal trusts, including all of the cases cited by the petitioner. As with any factual test that is uniformly applied, the *results* of the cases have differed, depending upon the *facts* proved in each case. Opposite facts have produced opposite results. The differing results of the cases are not the result of any conflict or disagreement among the lower courts, but are rather due to distinguishable facts.

Thus, where the evidence has convinced the court that a trust executed by one spouse for the benefit of the other was, in fact, executed in consideration of a trust executed by the other spouse for the benefit of the former, the spouse whose estate tax liability is in question has been held taxable reciprocally as settlor of the trust created by the other

spouse. *Estate of Hanauer v. Commissioner* (2nd Cir., 1945), 149 F. 2d 857, cert. den. 326 U.S. 770; *Orvis v. Higgins* (2nd Cir., 1950), 180 F. 2d 537, cert. den. 340 U.S. 810; *Cole's Estate v. Commissioner* (8th Cir., 1944), 140 F. 2d 636; *Estate of Carter v. Commissioner* (1959), 31 T.C. 1148; and *Estate of Fish v. Commissioner* (1941), 45 B.T.A. 120.

On the other hand, it is equally well established that, when the evidence indicates that the decedent's transfer in trust was *not* intended as the consideration or *quid pro quo* inducing his spouse to create a trust for his benefit, the *Lehman* doctrine is inapplicable, even where the husband and wife have simultaneously executed trusts having identical corpora and identical reciprocal provisions for the benefit of each other. *Estate of Guenzel v. Commissioner* (8th Cir., 1958), 258 F. 2d 248; *McLain v. Jarecki* (7th Cir., 1956), 232 F. 2d 211; *Estate of Newberry v. Commissioner* (3rd Cir., 1953), 201 F. 2d 874, 38 A.L.R. 2d 514; *In re Lueder's Estate* (3rd Cir., 1947), 164 F. 2d 128; *Tobin v. Commissioner* (5th Cir., 1950), 183 F. 2d 919, cert. den. 340 U.S. 904; *Commissioner v. McLean* (5th Cir., 1942), 127 F. 2d 924; *Estate of Ruxton v. Commissioner* (1953), 20 T.C. 8[illegible]; *Estate of Resch v. Commissioner* (1953), 20 T.C. 171; *Welch v. Commissioner* (1947), 8 T.C. 1139; and *Estate of Lindsay v. Commissioner* (1943), 2 T.C. 174.

While the Court of Claims, in the decision sought to be reviewed, may not have shed any new light on the body of law represented by the foregoing cases, it does, at least, reach a result consistent with all of those prior decisions as applied to its findings of fact. The absence of a consideration or *quid pro quo* furnished by the decedent (see findings

29 and 30, App. 54a) would make the *Lehman* doctrine inapplicable under all of the above-cited cases, and any error of the Court of Claims in imposing an additional burden upon the respondent to prove an absence of tax-avoidance motivation is immaterial to the result of the case, since that burden was amply met.

The petitioner, in its petition, attempts to convince this Court, by partial quotations selected at random and quoted out of context, that a conflict of decisions exists between the decision herein and two decisions of the Third Circuit Court of Appeals, as opposed to other decisions cited in the opinion. (Pet. 12-14, 19) Such a conflict, however, must rest on a belief that the courts, in the decisions cited by the petitioner, paid mere lip service to the requirement of a consideration or *quid pro quo*, while surreptitiously fabricating a fictional pretense of finding consideration that was in fact nonexistent. We submit that such a belief in the lack of integrity and intellectual honesty of the courts is without justification, and that it must be assumed that a court's finding of consideration or absence thereof in any particular case is adequately supported by a rational analysis of the facts disclosed by the evidence in the record before the court.

The cases relied upon most heavily by the petitioner are *Estate of Hanauer v. Commissioner*, supra, *Orvis v. Higgins*, supra, and *Cole's Estate v. Commissioner*, supra. These cases strongly support the legal principal followed by the decision sought to be reviewed, and are contrary to the theory fabricated by the petitioner from phrases quoted out of context in the petition.

In the *Hanauer* case, the Second Circuit stressed very strongly the crucial test of a finding whether that decedent's transfer in trust was in fact the consideration or *quid pro quo* that induced and motivated his wife to create the trust for his benefit. Explaining its prior decision in the *Lehman* case, the court stated (149 F. 2d at p. 858):

> "* * * this court held that to the extent that *the decedent's property*, by its transfer in trust, had served as *the quid pro quo effective to bring about his brother's transfer*, for purposes of the estate tax the decedent must be treated as the actual settlor under the indenture executed by his brother—or, in the words of the Act, as the person who had 'made a transfer' in the sense that *by the transfer of his own property* and the consequent impoverishment of his own estate he caused the transfer of his brother's property to be made." (Emphasis supplied.)

The court in Hanauer was reviewing a decision of the Tax Court in which it was expressly found as a fact that "Each created his respective trust in consideration of the other. Also, that Carrie H. Hanover created her trust because her husband, the decedent, created his trust." The court declared (149 F. 2d at p. 858):

> "We take these findings to mean that the estates created by decedent's trust *served as a quid pro quo for the trust which he caused his wife to make*." (Emphasis supplied.)

Upon review of the record, the court found "abundant evidence to support those findings." The facts emphasized in the opinion dealt with the "mental attitude of the decedent's wife" and her "knowledge and active participation" in the development and execution of *both* trusts, and her "belief" that the decedent was creating a trust of substantial dimensions. These mental factors pertaining to the wife's

subjective motives and intentions were relied upon "to support a finding that *her transfer was caused by his.*" (149 F. 2d 859)

In the decision sought to be reviewed herein, the Court of Claims distinguished the *Hanauer* case because of opposite facts concerning the motivation of the wife, since in the instant case there was no basis in the record for a finding that Janet Grace, in transferring Tullaroan and 40 shares of stock to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust; and, indeed, there is no evidence in the record that Janet Grace even *knew* about the creation of the Joseph Grace trust by the decedent (App. 15a; and see finding 12(e), App. 47a). In *Hanauer*, the wife had created her trust "because her husband, the decedent, created his trust"; in the instant case, on the other hand, the wife had created her trust "merely because the decedent requested that she do so". (App. 15a).

In *Hanauer*, the court emphasized that the motivation of the *wife*, and not of the decedent himself, was the crucial test — whether *she* was motivated or caused to transfer her property in trust by *his* transfer in trust. If the wife's creation of her trust were motivated, induced, and caused by the decedent's transfer in trust, then his transfer of property was the consideration or *quid pro quo* for his wife's trust, justifying treatment of him as its settlor. Since the case did not involve the question whether the wife should be treated as settlor of the husband's trust, it was immaterial whether the wife's transfer had been the motivating cause of the decedent's transfer in trust. To emphasize that the

wife's motivation, rather than that of the decedent himself, was the decisive factor, the court commented that "*his* motive was not controlling" (149 F. 2d at p. 859). In its petition, the petitioner twice quoted the latter phrase (Pet. 9-10 and 16) to support its argument that motives are "not controlling", and therefore the Court of Claims erred in inquiring into subjective motives. We submit, however, that this is a perversion of the *Hanauer* decision, which regarded the subjective motivation of the *wife* as all-important to ascertain whether her transfer was caused by his.

The *Hanauer* case also affirms strongly that the question whether one trust was made in consideration of the other trust is purely a question of fact, as to which the results will differ when different facts are found. The court found "no fundamental inconsistency" between the decisions of the Tax Court in that case and in the case of *Estate of Lindsay v. Commissioner*, supra, wherein similar trusts in substantially equal amounts executed by husband and wife at about the same time were held not taxable reciprocally under the Lehman doctrine, because the facts as found by the Tax Court indicated that the two trusts "were not made each in consideration of the other" (2 T.C. at p. 179). The Second Circuit pointed out that in both cases "it was within the power of the trier of fact to make its own conclusion from the basic facts", and that "neither due regard for legal principle nor indeed for consistent action required it to make a similar finding on the different record presented here * * *". The *Hanauer* decision further distinguished *Commissioner v. McLean*, supra, saying "* * * we need only

reiterate that the findings made there upon a different record cannot serve to impeach the findings here." So it is apparent that the only "conflict" between the Court of Claims decision in the instant case and the Second Circuit decision in the *Hanauer* case is that opposite facts have been found upon different records, requiring a different result by consistent application of the same legal principle.

Similarly, in *Orvis v. Higgins*, supra, the Second Circuit regarded the issue as purely a question of fact concerning subjective intentions of the parties, devoting the main body of its opinion to an analysis of the circumstances under which an appellate court may reject a trial judge's findings of fact. Petitioner cites the *Orvis* case as support for its argument that there is an "inference of reciprocity inherent in the fact that the two trusts were conceived of and established at about the same time" (Pet. 10). Actually, the case says nothing of the kind and, indeed, contains no mention of whether the trusts were conceived of and established at about the same time or at different times. Instead, the opinion recites the facts with reference to conversations which the husband and wife had with their son, their attorney, and each other, indicating a course of bargaining, negotiation and agreement in which the wife was an active participant, leading to the factual conclusion "that each of those trusts was made in consideration of the other" (180 F. 2d at p. 540). The opinion not only refers to "a case like this, on an issue relating to intention", but also states "we find that reciprocity was *intended*", (180 F. 2d at p. 541). So it can hardly be said that the case stands for anything

other than a finding of fact with respect to the subjective intentions of the parties as gathered from the evidence in the record of that particular case.

The case of *Cole's Estate v. Commisioner*, supra, most strongly relied upon by petitioner (Pet. 10, 11, 12, 14, 15, 16, 17, 18, 19), is somewhat complex, in that both husband and wife had died less than three weeks apart and both their estates were before the court in one consolidated case. The court advanced two alternative grounds of decision— one upholding the Tax Court in taxing each decedent *reciprocally* as settlor of the trust created by the other spouse, and the other, alternative, theory holding that each decedent's estate should be taxed *non-reciprocally* upon "the 300 shares which he himself transferred to the trust created by him" (140 F. 2d at p. 638). In that case, since both estates were before the court, it made no difference whether each decedent was taxed upon the trust that he himself (or she herself) created or upon the precisely identical trust created by his wife (or her husband). But in the present case it does make a difference whether the decedent is deemed to have been settlor of his own trust or of his wife's trust. Whatever else the *Cole's Estate* case may stand for, it certainly adheres rigidly to the requirement of a fact finding that one trust was made in consideration of the other trust, in order to tax the settlor *reciprocally* as having made a transfer to the *other* settlor's trust. Its first approach is to construe the findings of the Tax Court to mean that one trust was made in consideration of the other trust, pursuant to an exchange. But assuming, "arguendo"

that no specific finding of consideration was made, the court holds that the respective settlors *cannot* then be taxed reciprocally as settlors of each other's trusts, but, instead, each must be treated for tax purposes as settlor of *the trust which he himself created.* Whichever theory of *Cole's Estate* is considered, there is no conflict with the decision of the Court of Claims in the present case, which is in accord with the first theory that a finding of consideration is essential to reciprocal taxation, and also in accord with the second theory that in the absence of a finding of consideration the decedent must be regarded as having transferred his property to the trust which he himself created, rather than the trust created by his wife.

The *Cole's Estate* case was subsequently clarified and explained by the Eighth Circuit in *Estate of Guenzel v. Commissioner*, supra, where the court explained that the second alternative, regarding each settlor as non-reciprocal transferor to his own trust, was "the real basis for the decision". (258 F. 2d 254). In the *Guenzel* case, two trusts created by a decedent and his wife on the same day, identical as to form and value, having the same trustee, each naming the other spouse as primary life income beneficiary and himself as secondary life income beneficiary, were held to be not taxable reciprocally because of the failure to prove that one trust was in fact created in consideration of the other trust. In arriving at that conclusion, the court relied upon and quoted extensively with approval the cases of *Estate of Newberry v. Commissioner*, supra; *McLain v. Jarecki*, supra; and

Estate of Ruxton v. Commissioner, supra; also citing with approval *In re Lueders' Estate*, supra (258 F. 2d at pp. 251-254). The Court concluded:

> "We have heretofore indicated our view that there was no legal consideration for the creation of the respective trusts. Since there was no bona fide consideration for the establishment of the trusts, no foundation existed for the application of the Lehman doctrine."

Curiously, petitioner claims the *Guenzel* case as supporting its theory (whatever its theory is!) (Pet. 11, 16). Yet *Guenzel's* case is obviously in the mainstream of all the cases holding, as does the Court of Claims decision sought to be reviewed, that the *Lehman* doctrine is inapplicable when the facts of the case disclose the absence of a legal consideration.

The petitioner also claims that its theory is supported by *Glaser v. United States*, (7th Cir., 1962), 306 F. 2d 57; *Olsen v. Reismer*, (7th Cir., 1959), 271 F. 2d 623; and *Commissioner v. Warner*, (9th Cir., 1942), 127 F. 2d 913, but none of these cases can be construed to conflict with the Court of Claims decision in the present case. The *Glaser* and *Olson* cases are entirely irrelevant to the present case — both deal with transfers of jointly owned property in which the decedent retained an interest, and both hold only that the decedent's estate is taxable on his *own* half interest of which he had made a transfer under which he retained a life interest; neither case held the decedent taxable on his *spouse's* half interest in the jointly owned property. The petitioner's assertion that the latter two cases, which do not even involve the "reciprocal trust doctrine", somehow over-

ruled *McLain v. Jarecki*, (see Pet. 11, footnote 6) is patently absurd. And the petitioner points to nothing in *Commissioner v. Warner*, supra, which is even claimed to be in conflict with the main body of law holding that a finding of consideration furnished by the decedent is essential, that case being merely an obvious application of the *Lehman* principle that the person who furnishes the consideration for a trust is its settlor.

While the petitioner would lead this Court to believe that the Court of Claims decision in this case is in conflict with the decisions of the Tax Court (Pet. 19), the petition fails to cite a single decision of the latter court which it claims to be conflicting. The Tax Court, however, has consistently held that the reciprocal trust doctrine "should be applied only when clearly warranted by the particular facts of a case considered in the light of the decided cases," and that "We think the *motives* of the parties certainly have a bearing on their *intentions* with respect to unity of purpose, interdependence, and *consideration or the lack thereof.*" *Estate of Ruxton v. Commissioner*, supra, (20 T.C. at p. 494). Also the Tax Court has said that "Whether the party executing a trust instrument is the real settlor, or merely a nominal settlor * * * is, in each case, a question of fact. It is an inference to be drawn from all the facts and circumstances attendant upon the execution of the agreement." *Estate of Resch v. Commissioner*, supra, (20 T.C. at p. 183). When the Tax Court last considered the applicability of the reciprocal

trust doctrine in 1959, it said, in *Estate of Carter v. Commissioner*, supra, with reference to the "principle of the *Lehman* case" (31 T.C. at 1152):

> "Whether the principle is applicable in a given situation is, of course, dependent upon the particular facts presented. * * * Thus the issue resolves itself into a question of fact, namely whether Ernest and Laura each created his (or her) trust in consideration of the creation of the trust by the other. * * * The question is one of the motivations of the two settlors. Their candid testimony might, of course, be the best evidence of their motives in creating the trusts involved. Since they are both dead, we must rely upon other evidence to discern their motivations."

With reference to the cases of *Newberry's Estate v. Commissioner*, supra, and *McLain v. Jarecki*, supra, the Tax Court said in the *Carter* case (31 T.C. at p. 1154):

> "Because the question involved in all reciprocal trust cases is factual, little purpose is served by an extensive discussion of the factual background of each case. As we understand the *Newberry* and *McLain* cases, the decisive test for the application of the *Lehman* doctrine is whether the trusts were executed in consideration of each other. Our treatment of the issue here is consistent with this principle and we do not regard our disposition to be contrary to those cases."

Consistently with that principle, whenever the evidence and facts before the Tax Court have indicated the absence of intentions or motives to create one trust in consideration for the other, that court has held the *Lehman* doctrine inapplicable and has refused to tax a decedent's estate as if he were the settlor of a trust created without consideration by his spouse. See *Estate of Lindsay v. Commissioner*, supra;

Estate of Ruxton v. Commissioner, supra; *Estate of Resch v. Commissioner*, supra; cf. *Welch v. Commissioner* (1947), 8 T.C. 1139.

And, with respect to what constitutes consideration, the Tax Court (then Board of Tax Appeals) declared at the very inception of the reciprocal trust doctrine, in *McLean v. Commissioner*, (1940) 41 B.T.A. 1266, affirmed in *Commissioner v. McLean*, supra, as follows (41 B.T.A. at p. 1267):

> "The fact that the trusts were created at the same time and contained reciprocal provisions does not prove that one was created in consideration of the other, and the fact that the transfers were in equal amounts and made at the same time does not show that one was made in consideration of the other."

There is nothing in the consistent line of Tax Court decisions on the issue involved herein to suggest that the Tax Court would have made any different findings of fact than did the Court of Claims in this case, or that having made such findings it would have applied any different principles of law or reached any different result.

The only "conflict" that exists here is simply that the theory advocated by the petitioner is in conflict with *all* of the court decisions on the subject. The petitioner's theory, fabricated out of a scatter-shot quotation of selected phrases out of context, appears to be that whenever spouses have each created a trust, one spouse must always be treated for tax purposes as settlor of the trust created by the other spouse, rather than as settlor of the trust which

he himself created, notwithstanding that the facts of the case show that one trust was not made in consideration of the other. No court has ever so held. The consistent and harmonious application of the factual test, whether one trust was made in consideration of the other trust, does not require that the Government win in all cases, even when the facts are contrary to its contentions.

Although the Court of Claims questionably classified the seemingly harmonious cases into what it characterized as "two divergent views", it found that the facts of this case justified the same result under either view, and refrained from choosing between what it conceived to be "two lines of cases". (App. 4a-5a, 15a-16a). While we are not able to apprehend the divergence between the precedent cases, at least it is clear that the decision of the Court of Claims in this case is not in conflict with *either* of the "lines of cases", since it applied *both* "divergent views" and found that the facts of this case would entitle respondents to recover under *either* view.

There being no conflict between the Court of Claims decision sought to be reviewed and any other decision of any lower court, nothing could be resolved by granting of a writ of certiorari in this case.

2. *The judgment sought to be reviewed involves no issue of current importance.*

The "reciprocal trust doctrine" was productive of much litigation during the 1940's and 1950's, when the doctrine was developed, defined and refined in a long series of cases in

which this Court declined to intervene. (See cases cited above). This Court denied writs of certiorari in the *Lehman*, *Hanauer*, *Orvis* and *Tobin* cases, supra, in 1940, 1945 and twice in 1950, respectively.

The decision of the Court of Claims sought to be reviewed, like a ghost from a by-gone era, stands as the only solitary case in which any court in the country has been called upon to decide the issue of applicability of the reciprocal trust doctrine during the present decade. Very likely, it is the last case on the subject that ever will be litigated. For, since the principle was first established in the famous *Lehman* case, supra, in 1940, it has been so widely recognized and understood by tax and trust lawyers that it is extremely unlikely that any trusts would be permitted to fall into the apparent patterns of "reciprocal" trusts, subjecting them to needless taxes (except possibly in isolated instances of ignorant and ill-advised persons who may unwarily fall into this tax trap). The plethora of litigation on this issue during the 1940's and 1950's centered about trusts created prior to 1940, when the Lehman doctrine became known. Few of these pre-1940 trusts now remain in existence.

The trusts involved in the present case were created in 1931, when estate tax rates were so low as to be of negligible consequence, and these trusts were proved to have been made without seeking or obtaining any kind of tax advice. By contrast, in the modern age, when very high estate tax rates have prevailed for so many years, it is difficult to imagine anyone irrevocably transferring a million dollars'

worth of property in trust without first ascertaining the tax consequences and obtaining expert guidance.

There is no need at this point in history to go back and clarify the law applicable to trusts created in 1931 under circumstances which have long since ceased to exist.

This particular litigation about 1931 trusts was delayed in reaching the courts because of the unusual combination of circumstances that (1) the decedent lived for 19 years after creation of the trusts, so that the estate tax consequences did not become pertinent until his death in 1950; (2) the issue was not raised until an estate tax deficiency was assessed four years after his death; (3) claim for refund was not filed until the last day permitted by the statute of limitations, and the claim was not acted upon promptly, with the consequence that this suit was not filed until 1959, when the decedent had been dead for 9 years; and (4) this litigation consumed 9 more years from the filing of the complaint in 1959 to final judgment in 1968. These unusual circumstances have produced a case dealing with facts and law no longer relevant. The case should be consigned to the tomes of ancient lore, from whence it came.

An authoritative pronouncement from the Supreme Court defining the scope and limits of the reciprocal trust doctrine, and its application to circumstances existing in 1931, might have been salutary during the 1940's or 1950's, when many of these cases were being litigated. But at this late date, after the doctrine has long since ceased to be a subject of litigation, such a pronouncement could have no beneficial

effects. A doctrine so well established and widely accepted that it can be administered without producing any current litigation should not now be disturbed. A re-definition of the doctrine at this time could only serve to open new vistas of litigation as yet unthought of.

3. *The issue involved is purely a question of fact which has been determined from careful scrutiny and exhaustive analysis of the unique facts and circumstances shown by the evidence in this particular case.*

The question presented is essentially a determination of the facts of this particular case. These facts have been exhaustively analyzed, scrutinized, weighed, reviewed and determined, through a long and elaborate judicial process of trial and re-trial, briefing and re-briefing, argument and re-argument, by a trial commissioner and a seven-judge court — all eight of whom are competent and experienced jurists. There is no justification or need for the Justices of the Supreme Court to devote similar endless hours to a similarly exhaustive study of the voluminous record in this case to determine again facts that have already been determined. And there is no reason to suppose that if it did so this Court would arrive at any different fact findings than those already found by the Court of Claims. Nor is there reason to suppose that a more cursory and less detailed investigation would produce more reliable factual conclusions than those already reached by the Court of Claims.

Moreover, a re-finding of the factual issue involved would have no significance in any other case except this one. The

facts presented in this record are unique. No other case will ever involve the same facts as this one. The decision in this case, whether or not it is reviewed and re-decided by this Court, will not have much value as precedent in deciding other cases that involve different facts. At best, it can serve only as an analogy to other facts determined from other evidence presented in other cases.

The petitioner points to no error of substance or procedure in the lower court's findings of fact, but in essence asks this Court to reach a different factual conclusion. The factual conclusion reached by competent triers of fact in the court below should be permitted to stand undisturbed.

4. *There is no tax loophole requiring remedy by judicial legislation.*

The petitioner asserts that, unless reversed, the decision of the Court of Claims "will have reopened a glaring loophole in the estate tax law inviting new attempts by husbands and wives to deplete the value of their taxable estates while retaining full enjoyment of all their assets, simply by creating cross trusts in favor of each other with remainders to their children" (Pet. 19, and see Pet. 7). The assertion is ludicrous.

The decision of the Court of Claims certainly is not susceptible to the interpretation that it repeals the *Lehman* doctrine. Instead, it scrupulously applies the doctrine in perhaps the strictest terms ever applied by any court. It adds a new and additional requirement, never before imposed by any court, that in order to prevent inclusion in a decedent's

estate of a trust created gratuitously and without consideration by his wife, the estate must prove that the decedent was not motivated by a desire to avoid or lessen estate taxes when he suggested to his wife that she create the trust for his benefit. And that requirement cannot be dismissed as mere *obiter dictim*, for the Court of Claims actually remanded the case for another trial on that point after it had been proved and found that the two trusts had not been created in consideration of each other. The addition of this new requirement of proving the absence of tax avoidance motives adds a ponderous — and as a practical matter virtually unbearable — new burden of proof upon the taxpayer. This is hardly opening a "loophole". In all other respects, the decision conforms strictly to the long line of cases that make reciprocal taxation depend upon a finding that one trust was created in consideration of the other trust.

Surely, any persons attempting the tax avoidance scheme described by petitioner would be caught in their own "loophole", for they would not be able to prove initially, as respondents have proved in this case, that neither trust was made in consideration of the other trust. And even if they did convince a court on that point they would be unable to sustain the burden of proving by positive evidence, as respondents have proved in this case, that neither trust was in any way motivated by a desire to avoid or lessen estate taxes.

More important, justice requires that the estate involved in this case be taxed according to what the decedent, Joseph P. Grace, and his wife actually did with respect to the trusts

they created, instead of according to the petitioner's theoretical imaginings as to what *other* persons might attempt to do with respect to *other* trusts. It should be noted that even the petitioner does not claim that Joseph P. Grace and Janet Grace created these trusts in 1931 because of any motive to avoid estate taxes nor that either trust could have possibly had the effect of avoiding estate taxes. Since no "tax loophole" was involved in this case, it would be an injustice to these taxpayers to exact from them taxes not justly owed, on the pretense that this is necessary to prevent other taxpayers from creating loopholes in the future.

In the trust created by Joseph P. Grace on December 15, 1931, he appointed himself as one of the trustees, and retained the power in conjunction with either one of the other two trustees to terminate the trust at any time by distributing the principal of the trust to his wife [Finding 11 (a), App. 38a, clause *First*]. Thus, the decedent retained to himself a clearly taxable power in the Joseph Grace trust (see, e.g., *Lober v. United States*, 346, U.S. 335). The creation of that trust did not "deplete the value of his taxable estate" as the petitioner contends (Pet. 19), for it remained taxable as part of his estate as long as that trust remained in existence. When it terminated on the death of Janet Grace in 1937, and passed to the decedent's children, he lost all control over it, power with respect to it or interest in it, irrevocably and irretrievably. Only then did it cease to be taxable as part of his estate.

The decedent's wife, likewise, retained a power as trustee to terminate the Janet Grace trust at any time by distri-

buting the principal of the trust to the life tenant. That power undoubtedly left the Janet Grace trust taxable as part of the estate of Janet Grace under such cases as *Lober v. U. S.*, supra. Also, it appears that trust would remain taxable to her estate under Section 811 (c) (1) (B) and its predecessor, the joint resolution of March 3, 1931 (supra, p. 14) because she in fact retained the possession and enjoyment of the trust property for the remainder of her life [Finding 12 (c), App. 46a; see, also, App. 14a].

The decedent and his wife, having each created trusts that were *legally ineffective* to remove the properties which they respectively transferred in trust from the taxable estate of either of them, can hardly be said to have availed themselves of a tax "loophole".

The only significant benefit to the decedent under the Janet Grace trust was the right to continue living in the family homestead where he had lived for twenty years. The same result could have been accomplished if Janet Grace devised to her husband a life estate in the homestead under her will; or she could have by inter vivos gift granted him a legal life estate or an interest as beneficiary for life of a trust. In either instance, the property would not be includible in her *husband's* taxable estate merely because he was life tenant. There was no estate tax or other tax *advantage* to be gained by Janet Grace's transfer to the Janet Grace trust at a time close to the decedent's transfer to the Joseph Grace trust; indeed, the *only* tax or other consequence of these trusts being created within the same month was the *adverse* effect of creating the very issue litigated in this case,

subjecting the life tenant to the risk that his wife's trust might be taxed as part of his own estate when it would not otherwise be so taxable.

So, it is clear that the *real* issue here is not whether this decedent's estate should be allowed to benefit from a "loophole" resulting from the fact that he himself had created another trust only 15 days before his wife gave him the life estate in the homestead; but, instead, whether the mere fact of such timing is sufficient reason to require his estate to pay taxes on the property of which he was life tenant, when that property would otherwise not be taxable to his estate.

The petitioner's effort in this case is not to deprive the respondents of the benefit of a "tax loophole", but rather an attempt to extend the reciprocal trust doctrine, invented in 1940, retroactively to reach a trust created in 1931 which would not otherwise be taxable to this life tenant's estate, as a *tax trap* of which the decedent in 1931 could not be aware.

If it is a proper judicial function to close tax "loopholes", it just as clearly is not a proper judicial function to set tax traps for the unwary by indulging in legal fictions to extend the statute beyond its plain meaning. There is neither justice nor equity in the petitioner's attempt to exact a tax from the life tenant's estate in this case.

5. *The decision is right.*

The decision of the Court of Claims correctly applied the legal principle followed by the courts in all of the cases cited

above and in the petition. Its findings of fact are abundantly supported by the evidence and are unchallenged, and these facts can lead to but one legal conclusion in the light of the decided cases.

The simple question of fact whether one trust was created in consideration of the other may leave room for courts to reach different results when the facts are different. But that is what courts are for. Judges, lawyers and laymen alike — even tax collectors — understand and are familiar with the legal content and meaning of the term "in consideration of". This test, as laid down in the *Lehman* case and uniformly applied by the courts, has produced harmonious and proper results and is being successfully administered without resort to current litigation. It should not be changed.

But even if the consideration test be abolished as urged by the petitioner, the results of this case must be the same under any other test. For manifestly, when the decedent's wife granted him a life estate in the homestead which they had occupied for the past 20 years, and which they both intended to continue to occupy as their family home for the rest of their lives, with no change whatever in the use or enjoyment of the property resulting from his wife's transfer in trust [App. 14a; finding 12(c), App. 46a], this did not in any practical economic or realistic sense produce a result comparable to, or have the effect of, the decedent's having retained a life estate in the commercial investment properties that he had transferred in trust for his wife and children fifteen days earlier. It would require an unduly tortured and perverse interpretation of Section 811 (c) (1)

(B) to include the Janet Grace trust in the decedent's estate under a statute that in plain terms includes only "property * * * which the decedent has at any time made a transfer * * * under which he retained * * *" a life estate, when the facts of the case clearly demonstrate that the decedent's life estate in that trust property was received in a transfer made by his wife which was, in substance and reality, in intent and in effect, a gratuitous gift by her to him. To distort and extend the statutory meaning to include the Janet Grace trust as part of the decedent's taxable estate in this case would exalt form over substantial practical economic effects of the actions of the parties and the circumstances shown to exist.

The result of the decision sought to be reviewed is, in the light of the facts shown to exist, fair, just, right and in accord with the plain meaning and intent of the statute. The decision should not be disturbed.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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October 28, 1968.

CERTIFICATE OF SERVICE

I hereby certify that a copy of this brief was served on October 27, 1968, upon the Solicitor General by depositing it in a United States post office with air mail postage prepaid, addressed to the Solicitor General at his post office address.

Wm S. Downard

William S. Downard

ENTRY OF APPEARANCE

I hereby enter my appearance herein as counsel of record for the respondents.

Wm S. Downard

William S. Downard

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 574

UNITED STATES, PETITIONER

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY MEMORANDUM FOR THE UNITED STATES

1. Contrary to respondents' contention (Br. 2–13), the petition for a writ of certiorari was timely applied for—*i.e.* it was filed (28 U.S. 2101) "within ninety days after the entry" of the judgment of the Court of Claims—and is therefore within this Court's jurisdiction. The petition was filed on September 26, 1968, within ninety days after the Court of Claims' entry of judgment on June 28, 1968. Although the opinion of the Court of Claims, entered April 19, 1968, stated (Pet. App. 68a) as its Conclusion of Law that respondents "are entitled to recover, and judgment is entered to that effect", that did not constitute

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a final judgment which started the running of the 90-day period. As that decision expressly indicated (*ibid.*), "[t]he amount of recovery will be determined pursuant to Rule 47(c)" of the Court of Claims.

Under the Court of Claims practice this meant that the case had to be remanded to the trial commissioner for further inquiry into the amount to be recovered, and that the court's final action could not and would not be taken until the trial commissioner had made his determination, and, if necessary, that decision had been reviewed by the court.[1] In this case there was little room for controversy before the Commissioner, but that does not negative the fact that the action of the Court of Claims was not final until he had acted, and the Court of Claims had entered its judgment, which it did on June 28, 1968. (Pet. App. 69a, 71a.)

Where, as here, a court's decision indicates on its face that further proceedings, or formal judgment or order will follow, the decision is not a final judgment for purposes of certiorari or appeal to this Court. *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, 284-288; *Puget Sound Co.* v. *King County*, 264 U.S. 22, 24-25; *United States* v. *Schaefer Brewing Co.*, 356 U.S. 227. The fact that the judgment could have been computed from the prior record or decision is immaterial, and "however final the decision may be, it is not the judgment." *Puget Sound Co.* v. *King*

[1] This practice of the Court of Claims has been described by the clerk of that court in Peartree, *Statistical Analysis of the Court of Claims*, 55 Georgetown L. J. 541, 547, and n. 38 (1966).

County, supra, 264 U.S. at 25. Thus, in *United States* v. *Bianchi & Co.,* this Court granted certiorari, 371 U.S. 939, and decided the merits, 373 U.S. 709, notwithstanding the argument presented by the respondent in its brief in opposition, and answered by the government in a reply memorandum (No. 529, October Term, 1962) that the time for filing the petition expired ninety days after the Court of Claims' decision as to liability.

The government no doubt could have filed a petition upon the entry of decision here on April 19, 1968. That, however, is not because the entry of decision constitutes a "final judgment", but because this Court may review both interlocutory and final decisions of the Court of Claims. See, *e.g., United States* v. *Utah Construction & Mining Co.,* 384 U.S. 394; *United States* v. *Adams,* 383 U.S. 39, 41–42; *United States* v. *Central Eureka Mining Co.,* 357 U.S. 155; *United States* v. *Caltex, Inc.,* 344 U.S. 149; *Marconi Wireless Co.* v. *United States,* 320 U.S. 1. This flexibility is emphasized by the wording of the statute governing review of cases in the Court of Claims. Thus 28 U.S.C. 1255, states: "Cases in the Court of Claims may be reviewed by the Supreme Court by * * * writ of certiorari * * *". It carefully avoids limiting review to "final judgments or decrees", the language used in

28 U.S.C. 1257 to define this Court's jurisdiction to review State court decision.[3]

2. As for the merits, respondents misconceive the essence of the "reciprocal trust doctrine" developed by the courts and approved by Congress (see Pet. 7-12) in contending that this case presents "purely a question of fact" (Br. 38-39), and in attempting to resolve the conflict between this case and those relied upon by the Government by drawing tenuous "factual" distinctions between them (Br. 21-35). The cases that conflict with the decision here do not, as respondent assumes, turn on whether the decedent's inter vivos gift in trust for his wife's lifetime benefit, and her gift in trust for his lifetime benefit, were subjectively "intended" to furnish "consideration" or a *"quid pro quo"* for each other. Rather the test

[3] *F.T.C.* v. *Minneapolis-Honeywell Co.*, 344 U.S. 206 (see Br. 8-9), is irrelevant. There the court of appeals entered a final judgment that reversed the single contested part of a three part Federal Trade Commission cease and desist order, but that did not mention the two uncontested parts. The Commission filed a memorandum several weeks after the time for a petition for rehearing had elapsed, asking that the uncontested parts be enforced. The court of appeals then entered another judgment reiterating the reversal of the first part and affirming and providing for the enforcement of the other two parts. In dismissing the writ as untimely sought, this Court held only that once a final judgment is entered, the time for petitioning may not be enlarged except by a timely petition for rehearing or by a subsequent decree that (*id.* at 211) "changes matters of substance, or resolves a genuine ambiguity". Here the first judgment stated no money amount. It was only the judgment of June 28, 1968, that provided that the respondent was entitled to recover "four hundred nineteen thousand two hundred twenty-one dollars and five cents ($419,221.05), together with interest thereon from from July 14, 1954, as provided by law." (Pet. App. 69a.)

hinges on the net economic effect of the cross-transfers, and not on the motives—tax or otherwise—of the transferors. As the Eighth Circuit said in *Cole's Estate* v. *Commissioner,* 140 F. 2d 636, 638, to the extent that one trust is a substitute for the assets of the other, "there was no change in the economic position of either grantor."[3] See, also, Lowndes, *Consideration and the Federal Estate and Gift Taxes,* 35 Geo. Wash. L. Rev. 50, 80.

Respondents distinguish *Hanauer's Estate* v. *Commissioner,* 149 F. 2d 857 (C.A. 2), certiorari denied, 326 U.S. 770, on the theory (Br. 26) that there the wife created the trust in the decedent-husband's favor "because" he had created one in her favor, whereas here the wife did not "know" of the decedent's trust and created hers "merely because the decedent requested that she do so." Neither *Hanauer* nor any other of the cases following *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2), suggest that the reciprocal trust doctrine is any less applicable where the reciprocal trusts are brought about by one of the spouses acting on behalf of both. On the contrary, the doctrine would seem *a fortiori* applicable where, as here, one of the spouses is entirely passive and leaves it to the other to plan and effect the reciprocal gifts in trust.

Here the majority of the Court of Claims determined that the two trusts were executed within a span of two weeks, were virtually identical in terms,

[3] It is of course immaterial to observe as respondent does (Br. 29), that in *Cole*, the estates of both spouses were before the court.

were executed "in accordance with the plan of the decedent," and were "parts of what was essentially a single transaction" (Findings 10–11(a), 12(a), 13, 53(a); Pet. App. 9a–10a, 37a–39a, 43a–45a, 47a, 67a, 68a), and that the decedent "caused his wife" to execute her trust in his favor (Pet. App. 16a). On this record it is plain that every circuit which has considered the problem—with the possible exception of the Third—would have held for the government, so that there is indeed a conflict.

3. In asserting (Br. 35–36) that the issue here involved is of no "current importance," because this case is "the only solitary case in which any court in the country has been called upon to decide the issue of applicability of the reciprocal trust doctrine during the present decade", respondent completely ignores the fact that the lack of litigation in the last several years is but a consequence of the inability of taxpayers to persuade the courts of the legitimacy of the cross-trust device. They are, moreover, wrong in their claim that taxpayers, to take advantage of the decision here, must risk needless gift taxes. Gift tax rates are considerably lower than estate taxes (see Internal Revenue Code of 1954, Sections 2001 and 2502). Section 2012 of the Code allows a credit for gift tax paid in respect of a gift required to be included in the gross estate; and it even has been suggested that it is advantageous to risk the estate tax controversy on the ground that the gross estate would be reduced in any event by the amount of gift tax previously paid. See Lowndes and Kramer, *Federal Estate and Gift Taxes* (2d ed., 1962), 75; Warren and Surrey, *Federal Estate and Gift Taxation* (1961), 255. There is

nothing to be lost, therefore, by renewed attempts by wealthy individuals to diminish their taxable estates by the intra-family reciprocal trust device, unless the Court grants review and forecloses the prospect that such attempts may meet with success at least in some of the lower federal courts.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 574

UNITED STATES, PETITIONER

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The findings and opinion of the Court of Claims (R. 56–123) are reported at 183 Ct. Cl. 745. The opinion is also reported at 393 F. 2d 939.

JURISDICTION

The judgment of the Court of Claims was entered on June 28, 1968, and amended in a nonmaterial respect on July 3, 1968 (R. 124–125). The petition for a writ of certiorari was filed on September 26, 1968 and granted on December 9, 1968 (R. 126). The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Where, as parts of a single transaction, the decedent-husband and his wife each transferred separately owned property under substantially identical trust instruments, naming each other as life beneficiary and their family as remaindermen, whether the value of the property transferred by the wife for the lifetime benefit of the decedent-husband should be included in his gross estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939 as a transfer of property with a retained life estate.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * *

* * * * *

(c) * * *

(1) *General rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * * * *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the pro erty, or (ii) the right, either

alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; * * *

* * * * *

STATEMENT

Joseph P. Grace (the "decedent") died in July 1950 at the age of 73 (R. 107). At the time of his marriage to Janet Grace in 1908 and thereafter he was man of great wealth (R. 88). While at their marriage Janet had no wealth or property of her own, between 1908 and 1931 decedent transferred to her title to a number of properties, including the 167-acre estate, Tullaroan, where they lived, and other real estate and securities having a cost of almost $2,000,000 (R. 89-90).

Decedent alone exercised supervision and control over the family's business affairs. He made the decisions regarding the management and disposition of the property and financial interests that were in Janet's ownership as well as his own. Janet had no interest in and took no part in business affairs; she relied on her husband's judgment. When decedent decided that some formal action was required of Janet with respect to her property, he would have the appropriate instrument prepared for her execution (R. 88).

In December 1931, decedent had prepared for his and his wife's signatures two virtually identical trust instruments providing for his transfer of property in trust for Janet for her life and her transfer of property in trust for himself for his life, with the remainders under each trust to such of their children

or the settlor as were appointed by the life beneficiary's will. For the trust of which he was the settlor ("Joseph trust"), decedent selected all the investment properties of value that he still had and deemed suitable for the corpus. For the trust of which his wife was the settlor ("Janet trust"), he selected Tullaroan and shares of stock in a personal holding company which held some of Janet's securities. (R. 92, 94–98, 100–102, 116.)

For each trust he chose three trustees, two of whom were his brother and his nephew [1] and the third of whom was the respective transferor. Each life beneficiary was entitled to the entire net income and to any of the principal, including the whole, which a majority of the trustees decided to convey to him or her. Decedent was also entitled to use and occupy Tullaroan. Each trust instrument gave decedent, during his life, the sole power to sell, invest and reinvest the corpora. Decedent executed his trust instrument on December 15, 1931, and caused Janet to execute hers on December 30, 1931. (R. 71, 73, 92–94, 98–100, 101.)

During their respective lifetimes Janet had \$133,627 in income from the Joseph trust,[2] and decedent received \$389,465 in income from the Janet

[1] Respectively William Russell Grace and William G. Holloway (R. 92, 98, 113; 1966 Tr. 171, 248, 310).

[2] Janet died December 31, 1937 (R. 105).

trust.[3] Decedent and his wife lived at Tullaroan until death.[4] (R. 101, 105, 107.)

After decedent's death in July 1950, the Commissioner of Internal Revenue determined that the two transfers in trust were reciprocal and added $1,116,-888 to the value of the gross estate reported in the estate tax return, the value at decedent's death of the corpus of the Janet trust. A tax deficiency of $419,-221, including interest, was assessed and paid, and after denial of claim for refund this refund suit was timely brought. (R. 107–109.)[5]

The Court of Claims found that "decedent caused his wife to create the Janet Grace trust" (R. 71 and see R. 73), that Janet's role in the two transfers was purely passive (R. 70), and that both trusts

---

[3] In addition, in April 1932, four months after execution of the two trusts, decedent received securities having a book value of $173,434 from the principal of the Joseph trust. Decedent and his co-trustees exercised their right to turn them over to Janet and she simultaneously turned them over to decedent (R. 96, 104, 105).

[4] On January 27, 1932, decedent exercised his power of appointment under the Janet Grace trust to give her the right to use and occupancy of Tullaroan if he died first (which did not occur) (Def. Ex. 36).

[5] After Janet's death in December 1937 the Commissioner similarly ruled that the two trusts were reciprocal, and that, to the extent of the lesser in value, one of the trusts was includible in her estate. In a compromise agreement, the Commissioner accepted the Janet Grace trust as the one taxable to her estate and its corpus was appraised at her death at $612,-334. Mutually offsetting contentions with respect to this and other issues resulted in compromise adding $336,783 to her gross estate. (R. 105–106, 118–119.)

"were created by, or at the instigation of, Joseph P. Grace as parts of what was essentially a single transaction" (R. 122-123). The court held, however, with two judges dissenting, that Section 811(c)(1)(B) of the Internal Revenue Code of 1939 would require inclusion of the Janet trust in decedent's estate only if in creating the Joseph trust he "was furnishing consideration for—*i.e.,* * * * was paying for—the subsequent creation of the Janet Grace trust * * *." According to the court "[t]his * * * involves an inquiry into the element of motivation." (R. 60.) It concluded that decedent's actions were not motivated by any intention to furnish consideration for, or to induce, or pay for, the Janet Grace trust, because (R. 68) "neither the decedent nor Janet Grace had any desire to acquire property from the other." The majority further reasoned that there was no basis in the record for a finding that Janet Grace, in making her transfer, was influenced by the circumstance that the decedent had previously created his own trust—"[o]n the basis of the whole record, it is reasonable to infer that Janet Grace executed the instrument creating the Janet Grace trust, and that she transferred property to that trust, merely because the decedent requested that she do so." (R. 70.)

The court also held that the result would be the same if the "existence of consideration" was tested by the "objective" evidence, because decedent "never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust

* * * and caused his wife to create the Janet Grace trust" in 1931 (R. 70-71).

The dissenting judges argued (R. 80) that the majority has applied erroneous principles: "[T]he correct question—once the cross-trusts are seen as inter-dependent (as has been found here)—is whether the trusts created by the two settlors put both in approximately the same economic position, objectively, as they would have been in if each had created his own trust * * *." Because the transfers left decedent (R. 85) "up to the limits of his wife's trust, in the same position as if he had given himself, rather than his wife, the life interest under the Joseph trust," the dissenters thought the Janet trust should be included in decedent's estate. They were also of the opinion that even under the majority's "consideration-motivation" test the evidence showed that (R. 76) "in common sense * * * one of these inter-related trusts was in exchange for the other * * *" and that the decedent's actions were colored by estate tax avoidance motives (R. 77-79).

SUMMARY OF ARGUMENT

Section 811(c)(1)(B) of the Internal Revenue Code of 1939 provides for the inclusion in the gross estate of any transferred property in which a decedent retained a life estate. The general purpose of the statute, which has been recodified in Section 2036 of the 1954 Code, is but a specific application of the general theory of the estate tax as it was first enacted in 1916—that the gross estate must include all transfers of property which take effect upon the decedent's

death. The recognition that the retention of a life estate is in effect a testamentary disposition of the trust corpus taking effect upon death led to the passage in 1931 of the provision at issue here.

The present case involves a device known as a reciprocal trust. Decedent and his wife each established a trust giving the other a lifetime interest in the corpus. Had each established a trust while retaining a life estate therein, it would be clear that the transfers would fall within the purview of Section 811(c)(1)(B). Although the reciprocal trusts used here are outside the literal language of the statute, which speaks in terms of interests retained by the settlor, the judicial response to these and similar transactions has been to uncross the trusts and regard each party as the settlor of the other's trust. The leading authority, *Lehman* v. *Commissioner*, 109 F. 2d 99 (C.A. 2), certiorari denied, 310 U.S. 637, has been reaffirmed by the Second Circuit and has been followed by the Seventh, Eighth, and Ninth Circuits. Moreover, this judicial gloss on the statute was specifically approved by Congress in its passage of the Technical Changes Act of 1949. At that time the responsible committees recognized that the application of the *Lehman* rule was consonant with the general principle applicable in tax cases—that the economic substance of a transaction rather than the form must govern in determining tax consequences—and the Congress adopted legislation that gave limited relief, not applicable here, from certain of the tax consequences of the reciprocal trust rule.

Here, the overall state of affairs demonstrates that both trusts were created almost simultaneously as parts of a single transaction, that the decedent directed the creation of the two trusts, and that Mr. and Mrs. Grace experienced no net change in their economic positions, up to the extent of the value of the lesser of the two trusts. Thus, to that extent the net result is the same as though each of the Grace's had established a trust, retaining a life interest. Accordingly, the record presents a classic case for the application of the reciprocal trust doctrine.

The Court of Claims' holding to the contrary rests upon the belief that such trusts cannot be uncrossed unless decedent furnished "consideration" for the subsequent creation of his wife's trust. The court found crucial the absence of any evidence that either decedent or his wife were motivated to acquire property from the other. The essential error in this approach is the undue emphasis upon the subjective motivation of the parties—a factor which played no part in the formulation of the reciprocal trust rule in the various courts of appeals or in the approval of the rule by the Congress. Moreover, it is entirely unrealistic to ground the reciprocal trust doctrine upon subjective motivation in view of the fact that to the extent of the offsetting values the economic substance of such transfers is to leave the parties in exactly the same financial position as though each had given himself a life interest in the trust he had established. Taxpayers in this situation should each be regarded as the settlor of each other's trust. To

conclude otherwise would exalt form over substance and vitiate the purpose of Section 811(c)(1)(B).

Indeed, the overall scheme of the estate tax presents objective standards for inclusion of property in the gross estate that are grounded upon the retention of interests by the decedent. With the exception of the provision for gifts in contemplation of death (Section 2035 of the 1954 Code), taxability does not depend upon the motives of a settlor but upon the nature and effect of the transfer. The test enunciated by the Court of Claims would impose a highly unworkable standard, which would require an inquiry into the motives of deceased reciprocal donors. Since the creation of both trusts were related and the economic effect of the transfers left decendent's estate undiminished to the extent of the value of what he received, decedent's motive must be irrelevant in determining the applicability of the reciprocal trust doctrine.

To the extent that the authorities relied upon by the Court of Claims' majority suggest that subjective motivation is material, we believe that they are in error. There is no connection between the bargained-for consideration concept of the law of contracts or trusts and the well-settled reciprocal trust doctrine of the *Lehman* line of cases. The crucial basis of *Lehman* and its progeny is that each transferor retained the full enjoyment of all the lifetime rights which he had in his property. In any event, all of the cases relied upon by the Court of Claims are distinguishable.

Even assuming *arguendo* the correctness of the Court of Claims' subjective motivation test, the undisputed facts require a reversal of the decision below. Under the rationale of the majority opinion, respondents had the burden of showing that decedent did not intend his wife's trust to be a *quid pro quo* for his trust. The proof, however, is entirely the other way.

The Court of Claims erred in its suggestion that proof of a tax avoidance motive would supply the necessary evidence of "consideration". Nothing in Section 811(c)(1)(B) requires the presence of a tax avoidance motive in order for the statute to be operative. In any event, the record suggests no purpose for the establishment of these reciprocal trusts other than a desire to avoid both estate and gift taxes.

ARGUMENT

INTRODUCTION

The Internal Revenue Code imposes a graduated estate tax measured by the value of the net estate passing from a decedent at his death. Ever since the first modern federal estate tax was adopted in 1916, Congress has sought to foreclose attempts to avoid tax through incomplete transfers that leave the transferor a significant interest in or control over the property during his lifetime. Thus Section 209 of the Revenue Act of 1916, Ch. 463, 39 Stat. 756, 780, required that a decedent's estate include any amount he transferred in a transaction "intended to take effect in possession or enjoyment at * * * his death".

The successors of Section 209 have long included in the comprehensive statutory definition of "gross estate" not only assets passing directly at the decedent's death, but those transferred during his lifetime in which he retained a significant incident of ownership (1939 Code Section 811; 1954 Code Sections 2031–2044). Within the latter category are transfers "under which he has retained for his life * * * the right to the income from the property" (1939 Code Section 811(c)(1)(B); 1954 Code Section 2036), the statutory provision at issue in this case. These provisions, which date from 1931,[6] and related requirements now found in Sections 2036 through 2038 of the Internal Revenue Code of 1954, in effect include in a decedent's estate the value of any property he transfers for less than full consideration during his lifetime while retaining an economic interest or control which prevents the gift from becoming "complete" up until his death. See *Commissioner* v. *Estate of Church*, 335 U.S. 632, 644.

Much of the litigation under these statutory provisions has resulted from attempts to draft instruments or invent transactions that seek to avoid the literal terms of the statutory provisions, while leaving the decedent the lifetime enjoyment of his property. Not only the specific transaction in issue here, but also the general problem that this case typifies, find their origin "in the early 1930's [when] the collective imagination of the nation's tax attorneys was fired by the tax saving possibilities seemingly offered by the

[6] Joint Resolution of March 3, 1931, Ch. 454, 46 Stat. 1516–1517.

use in closely-knit family groups of a trust device which has since become generally known as reciprocal, cross or parallel.'"[7] Under this device two or more people would each establish a trust, giving one of the others a lifetime interest in or some power over the corpus. Such an interest or power, if retained in favor of the settlor of the trust, would have required inclusion of the corpus in the settlor's estate upon his death. The hope was to avoid the thrust of the predecessors of Sections 2036–2038, which then, as now, expressly spoke only in terms of interests or powers retained in the settlor.

Although these "reciprocal" or "cross" trust transactions were in fact outside of the direct language of the statute, the courts, as soon as they were faced with the question, treated such transfers for what they were—attempts to use somewhat unorthodox approaches to achieve the substance of the partial transfers that Congress sought to deter. The courts uncrossed these trusts, relying on the fundamental rule, repeatedly reaffirmed by this Court, that tax consequences flow from the economic substance and effect of a transaction, and not its form.[8] The estate tax was applied as though each participant in a cross trust scheme was in fact the settlor of the trust in which he had an interest or over which he had a power. Then, in 1949, Congress expressly approved this line of decisions, when it adopted a pro-

[7] Colgan and Molloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device*, 3 Tax L. Rev. 271 (1948) (footnotes omitted).

[8] See, *e.g.*, *Helvering* v. *Hallock*, 309 U.S. 106, 114; *Goldstone* v. *United States*, 325 U.S. 687, 691; *United States* v. *Wells*, 283 U.S. 102, 116–117.

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vision to give limited tax relief to certain of these cross-trust devices—not by mitigating the estate tax consequences, but by allowing certain types of retained powers to be released without incurring additional gift taxes.

In this case, "as parts of what was essentially a single transaction" (R. 122–123), the decedent-husband and his wife created similar trusts of portions of their separate estates, each naming the other as life beneficiary and their children as remaindermen. Applying the "reciprocal trust" doctrine, the Commissioner determined that upon the husband's death the lesser value of the corpus of the trust created by the wife for his lifetime benefit was includible in his gross estate under 1939 Code Section 811(c)(1)(B) as a transfer of property with a retained life estate. The Court of Claims (two judges dissenting), viewing the cross-gifts between the donor-donee spouses as if they were gifts to third parties, held that the reciprocal trust doctrine was inapplicable and accordingly overruled the Commissioner's determination.

In this brief we shall first review the line of cases which Congress approved in 1949. Those demonstrate that the transfers here are the prototype of the reciprocal trust described and disapproved by the Congressional committees in 1949. This history, as well as the general tax principles which form its foundation, fully demonstrate that the property Mrs. Grace transferred in trust for her husband's benefit must be included in his estate.

I

THE RECIPROCAL TRUST DOCTRINE REQUIRES THAT THE TRUSTS BE UNCROSSED SO THAT THE BENEFICIARY OF EACH TRUST IS DEEMED ITS SETTLOR FOR FEDERAL ESTATE TAX PURPOSES

The issue involved in this case was first considered by the Second Circuit in 1940; in the ensuing decade a line of decisions in the Second, Eighth and Ninth Circuits ruled that reciprocal trusts must be taxed according to the economic substance and effect of the transactions and not their form. In result, the settlors were "uncrossed", so that the beneficiary of each trust was treated as the settlor for the purpose of applying Section 811 of the Internal Revenue Code of 1939 and its predecessors.

The first decision, and the one that other courts have treated as the seminal authority, was *Lehman* v. *Commissioner,* 109 F. 2d 99 (C.A. 2), certiorari denied, 310 U.S. 637. There the decedent and his brother each had created in 1930 a trust of corporate shares of stock for the other's benefit for life, with remainder to the life tenant's issue, and each brother also gave the other the right to withdraw $150,000 from the principal of the trust for his benefit. Had each brother given himself the right to make the withdrawal from the trust he had established, the sum would have been included in his gross estate as an interest "of which the decedent has at any time made a transfer * * * where the enjoyment thereof was subject at the date of his death to * * * a power * * * to * * * revoke." Section 302(d) of the Internal Revenue

Act of 1926, Ch. 27, 44 Stat. 9, 71 (similar to 1939 Code Section 811(d) and 1954 Code Section 2038).[9] When one of the brothers died, his estate argued that Section 302(d) could not be applied, because he did not have a power over a trust that he himself had established.

The Second Circuit, however, disagreed. Affirming the Board of Tax Appeals, it held that the $150,000 must be included in the estate, just as though the decedent himself had established the trust from which he was allowed to withdraw corpus. The court thought the situation (109 F. 2d at 100) "in substance the same" as though "the decedent had transferred his share of the property to trustees for his own use for life, remainder to his issue, and had reserved power to withdraw $150,000." The court reasoned (*ibid.*):

> the fact that the trusts were reciprocated or "crossed" is a trifle, quite lacking in practical or legal significance. * * * The law searches out the reality and is not concerned with the form.

In addition, in the light of the stipulated facts showing that each transferor had agreed to transfer his shares "in consideration of" the other's agreement to the same effect (*id.*, 100; see, also, 39 B.T.A. 17, 20), the court ruled (109 F. 2d at 100):

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[9] Only the $150,000—and not the remainder of the corpus—was placed in the estate, because the then prevailing case law held that transfers of property reserving life estates, made prior to the Joint Resolution of March 3, 1931, *supra*, were not includible in the gross estate. 109 F. 2d at 101; see *Hassett* v. *Welch*, 303 U.S. 303. However, as this Court held subsequently in *Commissioner* v. *Estate of Church*, *supra*, the entire corpus was also includible under the preexisting "possession or enjoyment" provision (Section 811(c)(1)(C)), even if the transfer occurred before 1931.

> * * * [T]he outcome would be the same if the decedent had transferred his share outright to his brother. The decisive point is that the decedent * * * caused the brother to make a transfer of property in trust under which the decedent had the right to withdraw $150,000 from principal * * *. "A person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another." Scott on Trusts, section 156.3.

In *Hanauer's Estate* v. *Commissioner,* 149 F. 2d 857, certiorari denied, 326 U.S. 770, and *Orvis* v. *Higgins,* 180 F. 2d 537, certiorari denied, 340 U.S. 810, the Second Circuit reaffirmed *Lehman.* These were cases, such as the present one, where husband and wife each created a trust for the other's lifetime benefit with remainder to their joint issue.

In *Hanauer,* the court of appeal affirmed the Tax Court's finding that the failure of the husband and wife each to create his or her respective trust (149 F. 2d at 858) "independently and apart" showed that each was established "in consideration of the other." In doing so, the court made clear that it did not refer to consideration in the sense of a negotiated bargain in which each party is motivated by the desire to obtain the other's property. Rather the court said (*id.,* 859) that the decedent-husband's "motive was not controlling" and that it was "not essential" to support the inclusion in the husband's estate that there be evidence to "support a finding that the wife's transfer was effective to bring about the decedent's transfer." Indeed, much like the pres-

ent case, the wife was "accustomed to rely upon the business men of the family" (*id.*, 858); she set up her family trust "only because of her conviction that 'if he (the decedent) thought it was good for him it would be good for me to do too' "; she "did not know the value of" her husband's trust; and she even left it to her husband and son-in-law to select the properties for her trust (*id.*, 858–859). The fact that (*id.*, 859) "the two trust indentures were contemporaneously developed and executed as though all part of a single transaction" was sufficient to support the Tax Court's finding that they were "in consideration of" each other (*id.*, 858). Then, in *Orvis*, the same court reversed a district court decision for the husband's estate where the family trusts were executed six days apart, on the basis of the spouses' knowledge of each other's intentions and the absence of any independent reason for the crossed life estates.

The Eighth Circuit decided the question in *Cole's Estate* v. *Commissioner*, 140 F. 2d 636. The husband, in 1931 had transferred 700 shares of stock in trust for his wife for life with remainder to their children and grandchildren, and on the same day the wife had transferred 300 shares in trust for the husband for life, with the same remaindermen. Both the husband and wife died during 1939. The court held that 300 shares should be included in each estate. In rejecting the taxpayer's argument that the Tax Court's decision in favor of the government was fatally defective because there was (*id.*, 637) "no finding that one trust was made in consideration of the other," the court concluded that the lower "court's decision

may be sustained on another basis". Thus it thought the situation was "the same as if one decedent had 'exchanged' 300 of his shares for 300 shares of the other. * * * [I]n an exchange the property received is consideration for the property given" (*ibid.*). The court of appeals further observed that even in the absence of the "exchange", the reciprocal trusts would not have operated to exclude the stock from the estate tax because the transferors retained "equivalents" (*id.*, 638):

> each decedent "retained the substance of full enjoyment of all the rights [for life] which previously he had in the property." *Helvering* v. *Clifford*, 309 U.S. 331, 336 * * *. To the extent of the income from 300 shares of the stock there was no change in the economic position of either grantor.

And the court insisted that the decedent's motives were immaterial, as (*id.*, 638) "with few exceptions the law attaches legal consequences to what parties do, quite independently of their private purpose or intent". The Eighth Circuit, like the Second, has reiterated and adhered to its position in subsequent cases. See *Guenzel's Estate* v. *Commissioner*, 258 F. 2d 248, 254; *Moreno's Estate* v. *Commissioner*, 260 F. 2d 389.

The Ninth Circuit, in a case growing out of a round robin of trusts established by three brothers, each for the benefit of one of the others, relied on *Lehman* in holding that the beneficiary of each trust should be treated as the settlor for gift tax purposes. *Commissioner* v. *Warner*, 127 F. 2d 913. And the Seventh

Circuit has twice followed the lead of *Lehman* in applying the estate tax. *Olson* v. *Reisimer*, 271 F. 2d 623, and *Glaser* v. *United States*, 306 F. 2d 57.[10]

The rule developed in this line of cases refuses to allow formal devices to overcome the requirement that a taxable estate include any amounts the decedent transferred during his life while retaining an interest in or power over the property. Rather, this "reciprocal trust" rule looks to the economic effect of what has occurred. Unless the taxpayers can show that the trusts were wholly unrelated to each other, they are reciprocal. Once they are so classified, the trusts must be uncrossed, and each included in the estate of the

[10] Compare, however, the two to one decision in *McLain* v. *Jarecki*, 232 F. 2d 211, where the Seventh Circuit affirmed a trial court decision declining to find reciprocity in trusts created by husband and wife, each having provided that the other was to receive the trust income after the settlor's death. The court based its decision on a conclusion that none of the stipulated facts expressly showed that the husband "brought about the transfer from his wife * * *." (*Id.*, 213.) In *Glaser* v. *United States*, *supra*, though, in an indistinguishable situation, the same court reversed a district court finding that there was no reciprocity in a transaction where a husband and wife conveyed land in fee to their daughter and son-in-law at the same time as the latter conveyed land to the parents for life with the remainder to another child. Without referring to its earlier decision in *McLain* the court ruled that (306 F. 2d at 61) "looking through form to substance, however, decedent and his wife merely substituted one piece of property for another of equal value." Thus, the father's estate was taxed on the value of half the property he received—"as if the transfer * * * had emanated from decedent and his wife and as if they had retained joint life interests therein." Consequently we assume that *Glaser* and *Olson*—and not *McLain*—represent the rule that now applies in the Seventh Circuit.

respective beneficiary, to the extent they offset each other. Subjective motivation—*i.e.* whether each transferor *intended* to give consideration—is immaterial. The economic facts themselves control the tax consequences.

This result is as it should be. The courts have repeatedly refused to allow formalisms, however ingeniously devised, to be used to escape tax consequences that Congress has attached to a transaction having a particular economic substance. Once it is shown that a decedent and one or more other persons each has an interest in, or a power over, a trust one of the others created, the overall state of affairs must be measured against the purpose of Section 811 or the parallel provisions of the 1954 Code. The statute must be applied so as to include in the decedent's estate the value of the trust of which he is a beneficiary, at least to the extent that it offsets the value of property he transferred for one of the other's benefit, since the result is exactly the same as though the decedent had retained an interest in, or power over, the trust he himself transferred. To rule otherwise, as the Court of Claims has, would allow those in a position to place large sums in trusts to deplete their taxable estates while retaining full enjoyment of all their assets, simply by creating cross trusts in favor of each other with remainders to their children.

II

CONGRESS HAS APPROVED THE RECIPROCAL TRUST DOCTRINE OF THE *LEHMAN* LINE OF CASES

The rule in *Lehman* and *Cole's Estate* was commonly accepted as having put to rest—at its birth—this once popular device for avoiding estate tax. See Colgan and Molloy, *Converse Trusts—The Rise and Fall of a Tax Avoidance Device,* 3 Tax L. Rev. 271, 273 (1948). These cases, moreover, formed the background for the Congressional action that, in 1949, demonstrated full legislative approval of the *Lehman* rule.

At that time persons who had participated in reciprocal trust arrangements had made transfers of their property that in form were complete. Yet, because of *Lehman,* they had failed in their efforts to take the property out of their taxable estates, since, in substance, they had retained some interest in or a power over the property. To remove such property from the estate by means of an inter vivos surrender of that interest or power would result in a taxable gift. Furthermore, such a transfer possibly could have estate tax consequences as a transfer in contemplation of death.

In the enactment of the Technical Changes Act of 1949, Ch. 720, 63 Stat. 891, Congress was requested to mitigate the burdens of these tax consequences. The committee reports expressly endorse the rule of *Lehman* as necessary and sufficient to overcome a tax avoidance device. Thus, the Senate Committee stated

(S. Rep. No. 831, 81st Cong., 1st Sess., pp. 5-6):

6. *Reciprocal trusts.*

Prior to 1940 certain reciprocal trusts were established with the apparent intent of minimizing estate taxes by what were then considered effective means. For example, an individual might establish a trust providing that the corpus of the trust would be payable to his children upon his death. Under the general plan followed, certain rights in the trust were also given to his wife. These rights might consist of a general power to invade the corpus, to change the beneficiaries or to change the amount which they would receive. At the same time or a short time after the husband set up the trust, his wife would also establish a trust with assets of a similar amount, vesting in him powers equivalent to those he had vested in her. By this reciprocal device it was thought that two persons could transfer property to their heirs without diminishing effective control during life but still paying the gift tax rather than the estate tax.

The acceptance by the Treasury, prior to 1939, of the gift taxes paid (and, it is claimed, the assertion of occasional deficiencies) caused some taxpayers to believe this was a legitimate device.

However, in 1940 in *Lehman* v. *Commissioner,* 109 Fed. (2d) 99, the Circuit Court of Appeals for the Second Circuit held that where trusts are found to have been created each in consideration of the other, the nominal grantors are to be interchanged for tax purposes. Thus, in the type of case discussed above, the husband would be considered the grantor of the trust created by the wife, and vice versa. This

means that the husband is considered to have reserved powers in the trust nominally set up by his wife. This, under present law, is sufficient to require inclusion of the entire trust corpus in his gross estate upon his death.

The court decisions in 1940 and subsequent years put taxpayers on notice as to the probable tax consequences of reciprocal trusts in the future. * * *[11]

Section 6(a) of the Technical Changes Act of 1949, *supra*,[12] allowed grantors of trusts with reciprocal powers created prior to 1940 (the year when *Lehman* was decided) an opportunity—good until December 31, 1950—to relinquish the retained powers without incurring additional gift tax, if gift tax had been paid on the original transfers.[13] Section 6(c) also allowed relinquishment to be made without possible estate tax liability as a gift in contemplation of death. Congress, however, denied similar relief to transferors who wished to relinquish (S. Rep. No. 831, *supra*, p. 6) "a life estate or other interests (as distinguished from * * * a power) which has been created in a reciprocal trust". Presumably Congress agreed with this Court's statement in *Commissioner*

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[11] The House Committee Report makes a substantially similar statement. H. Rep. No. 920, 81st Cong., 1st Sess., p. 5.

[12] A new subsection 1000(g) was added to the Internal Revenue Code of 1939.

[13] See, also, H. Conf. Rep. No. 1412, 81st Cong., 1st Sess., p. 6. In contrast, Section 8 of the same Act allowed the tax free release of a retained life estate, or a reciprocal life estate, under a transfer made prior to the Joint Resolution of March 3, 1931. The purpose was to grant relief from some of the consequences of the 1949 decision in *Commissioner* v. *Estate of Church*, see p. 16 n. 9, *supra*.

v. *Estate of Church, supra,* at 645, that retention of the right to income for life is "far more than [to] attach a 'string' to * * * property," but is retention of "a most valuable property" right which prevents a gift from becoming "complete", and therefore did not merit special relief.

The legislative purpose could not be clearer. Congress saw *Lehman* as an appropriate judicial response to a taxpayer "device" used in an attempt to avoid Section 811(c)(1)(B) and its predecessors. To ease some of the tax consequences of *Lehman* limited tax relief was granted to those who failed to anticipate that the courts would rule as the Second Circuit did in that case. The objective plainly was to facilitate the continuing judicial application of the *Lehman* case.

Moreover, the relief granted was severely limited, apparently to what Congress thought were the situations where a taxpayer, before *Lehman,* might reasonably have failed to anticipate the reciprocal trust rule. Thus relief was denied to anyone who established such a trust after *Lehman,* and even those people were given but a limited time to relinquish the powers retained over property placed in a reciprocal trust before *Lehman.* Furthermore, the relief was limited to only those who retained powers over—as opposed to a life interest in—the cross trusts, thus reflecting an apparent Congressional judgment that even before *Lehman,* the creation of crossed life interests—as occurred here—presented a rather obvious case for uncrossing the trusts.

It is therefore the standards developed in *Lehman*, *Cole's Estate*, and like cases that must control this litigation. The trusts involved here and the circumstances of their formation are essentially indistinguishable from the ones involved in those cases, and the present problem must yield to the analysis advanced in the Second and Eighth Circuits and accepted by the Congress. We shall now turn to an application of that analysis to the facts of this case, and an examination of the grounds advanced by the Court of Claims for its decision that Mr. and Mrs. Grace managed to place their property beyond the reach of Section 811(c)(1)(B) of the Internal Revenue Code of 1939.

III

THE COURT OF CLAIMS ERRED IN HOLDING THAT DECEDENT'S AND HIS WIFE'S TRANSFER TO AND RECEIPT OF PROPERTY FROM EACH OTHER WERE INSULATED FROM THE *LEHMAN* RULE

A. THIS CASE PRESENTS THE PROTOTYPE OF THE RECIPROCAL TRUST DEVICE ENCOMPASSED BY THE RULE OF *LEHMAN*

There is no dispute about the crucial facts of this case. The decedent-husband transferred properties in trust for his wife for life with remainder to their family, and under a virtually identical trust, arranged simultaneously by the decendent (R. 92) but dated two weeks later, "acting in accordance with the plan of the decendent" (R. 98, and see also R. 65), his wife transferred properties in trust for his life with similar remainder. The properties transferred by the wife

were those (R. 101) "previously selected by the decedent." The two trusts were established as (R. 122–123) "parts of what was essentially a single transaction," and the husband (R. 71 and see R. 73) "caused his wife" to execute her trust.

This record thus presents the prototype of the reciprocal trusts described by the Congressional Committees in 1949. Since the parties remained in the same economic position (to the extent of the lesser value of the wife's trust) as if each had created a trust of his or her own property with a retained life estate in the same property, the value of the property transferred in trust by decedent's wife was substituted for his own and should be includible in his estate under Section 811(c)(1)(B). By making reciprocal transfers each transferor-transferee in effect and for all practical purposes "retained" for life the enjoyment and right to the income from the property he had transferred up to the extent of the lesser value of the trust he had his wife establish for his own benefit. On this record this case is entirely indistinguishable from *Hanauer's Estate, supra, Orvis* v. *Higgins, supra,* and *Cole's Estate, supra.* It thus comes within the rule approved by Congress in 1949, and that rule requires the inclusion of the value of the Janet trust in decedent's estate.

B. THE COURT OF CLAIMS ERRED IN HOLDING THAT THE *LEHMAN* RULE WOULD APPLY ONLY IF DECEDENT HAD A SUBJECTIVE DESIRE TO OBTAIN HIS WIFE'S PROPERTY

In this case, the primary holding of the majority of the Court of Claims was that the reciprocal trust rule

of *Lehman* (R. 60) "involves an inquiry into the element of motivation," and that the Janet trust should be included in decedent's estate only if he, in creating his trust, "was furnishing consideration for—*i.e.*, whether he was paying for—the subsequent creation of the Janet Grace trust." In deciding this question in favor of the taxpayer, the court concluded (R. 68) "neither the decedent nor Janet Grace had any desire to acquire property from the other"; "the decedent, when he created the Joseph Grace trust * * * was not motivated by any intention to give consideration for, or pay for" or (R. 69) "to induce Janet Grace to transfer" her assets in favor of decedent.

But this approach misconceives the interpretation of Section 811(c)(1)(B) of the 1939 Code rendered in *Lehman* and approved by the Congress in 1949. Nothing in the cases approved by Congress depends on or calls for "an inquiry into the element of motivation." To the contrary, the Second Circuit insisted in *Hanauer's Estate,* 149 F. 2d at 859, that the decedent's "motive was not controlling". And the Eighth Circuit made clear in *Cole's Estate* that the settlors should be uncrossed whenever the trusts have left the decedent's economic position essentially unchanged. See 140 F. 2d at 637. See, also, *Guenzel's Estate* v. *Commissioner, supra,* 258 F. 2d at 254; *Olson* v. *Reisimer, supra,* 271 F. 2d at 626-627, quoting from *Moreno's Estate, supra,* 260 F. 2d at 392.

Nor should questions of subjective motivation play any part in determining whether decedent's estate should include the value of the Janet trust. The essential question instead goes to the relationship between

the trusts. Since, as the Court of Claims found, respondents failed to prove that each trust was unrelated to the other, there can be only one answer to that question here. The two trusts were executed within a span of two weeks, were virtually identical in terms, were executed "in accordance with the plan of the decedent," and were "parts of what was essentially a single transaction" (R. 92–94, 98–100, 102, 122–123). Decedent in addition "caused his wife" to execute her trust in his favor (R. 71 and see also 73). On this record it is plain that these trusts were intimately connected in their inception and that is enough to invoke the rule of *Lehman*.

Once these facts are found, the subjective reasons that motivated Mr. and Mrs. Grace can have no pertinence. Of course, neither decedent nor his wife was prompted by a desire to purchase or obtain the property of the other. But what would be the significance of such a motive? Under the series of transfers the decedent devised and had executed, there was no practical change in the family financial condition. As a result of the transfers, Joseph Grace did not part with more than the difference between the value of his transfer to Janet and her transfer to him. To this extent the situation is in substance exactly as though he had established one trust for his own benefit, and she had established one for her benefit. In these circumstances, the trusts must be uncrossed for the purpose of applying Section 811(c)(1)(B) of the 1939 Code, unless the substance of what occurred is to be entirely masked by the form of the trusts.

This is the only result that can be squared with the purpose of Section 811(c)(1)(B) and the related provisions of the estate tax. In construing and applying taxing statutes—whether income, gift, or estate tax provisions—this Court and lower courts have consistently looked through legal form to economic substance.[14] Thus this Court has held on several occasions that an estate tax cannot be avoided by any trust transfer except by (*Commissioner* v. *Estate of Church*, *supra*, at 645; *Estate of Spiegel* v. *Commissioner*, 335 U.S. 701, 705):

> a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property.

It is equally settled that the means a taxpayer uses to retain the economic value or control of his property are of little importance, since (*Goldstone* v. *United States*, 325 U.S. 687, 691):

> Testamentary dispositions of an *inter vivos* nature cannot escape the force of this section by hiding behind legal niceties contained in devices and forms created by conveyancers.

And (*Commissioner* v. *Estate of Church*, *supra*, at 644)—

> "In determining whether a taxable transfer becomes complete only at death we look to sub-

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[14] *E.g.*, *Commissioner* v. *Estate of Church*, *supra*; *Goldstone* v. *United States*, *supra*; *Estate of Spiegel* v. *Commissioner*, *supra* (estate tax); *Burnet* v. *Guggenheim*, 288 U.S. 280 (gift tax); *Gregory* v. *Helvering*, 293 U.S. 465; *Knetsch* v. *United States*, 364 U.S. 361; *Commissioner* v. *Brown*, 380 U.S. 563; and *Helvering* v. *Clifford*, 309 U.S. 331 (income tax).

> stance, not to form * * *. However we label the device [if] it is but a means by which the gift is rendered incomplete until the donor's death" the "possession or enjoyment" provision applies.

The rule which we urge here is but an application of these principles to the device of reciprocal trusts. The estate tax is on the "value" of property passing at death, rather than on any other measure. An *inter vivos* transfer of properties under which the transferor retains the continuing right to their possession, enjoyment and income is a retention of (*Commissioner* v. *Estate of Church, supra,* at 644) "[p]robably their greatest property value," which prevents the value of the decedent's estate from being depleted. This being so, in economic reality it makes no difference to the transferor whether the "value" he retains up to his death is in the precise property he transferred or its equivalent value in substituted property.

With one exception—the section dealing with transfers in contemplation of death [15]—the scheme of taxing estates is grounded upon the net economic effect of a decedent's actions. The essential concept of the statute is to allow the value of property to escape the estate tax only if the decedent completely parted with it during life. However, the date-of-death value of all property transferred during life is included in the gross estate if the decedent retained some significant interest in it. In the application of these provisions, economic realities have always superseded

[15] Section 811(c)(1)(A) of the 1939 Code; Section 2035 of the 1954 Code.

questions of the decedent's subjective motive. Thus this Court said with respect to transfers "intended to take effect in possession or enjoyment at or after [decedent's] death"[16] (*Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 705–706), taxability "does not hinge on a settlor's motives, but depends on the nature and effect of the trust transfer." It is even "immaterial" whether the reservation of such a power is "deliberate", for "[a]ny requirement * * * such as a post-death attempt to probe the settlor's thoughts in regard to the transfer, would impair the effectiveness of the 'possession or enjoyment' provision as an instrument to frustrate estate tax evasions." If this is true with respect to Section 811(c)(1)(C), which uses the word "intended," it can hardly be less true with respect to Section 811(c)(1)(B)—at issue here—which includes in estates the value of property transferred while the decedent in fact "retained" possession or enjoyment for life. As this Court said *Commissioner* v. *Estate of Church, supra,* 335 U.S. at 638:

> "It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate." *Matter of Keeney,* 194 N.Y. 281, 287, 87 N.E. 428, 429; *Keeney* v. *New York,* 222 U.S. 525. * * *

To apply to prearranged husband and wife crossed trusts and life estates the test of whether or not they were induced by the desire to obtain each other's property, in order to determine whether they are includible in the gross estate under Section 811(c)(1)

[16] Section 811(c)(1)(C) of the 1939 Code; Section 2037 of the 1954 Code.

(B), would nullify the reciprocal trust rule in the field in which Congress thought it had its most important application. See (pp. 22–25, *supra.*) As the dissenting judges in the Court of Claims pointed out (R. 72), the desire to obtain each other's property is the least of husbands' and wives' normal motivations for such crossed transfers. Wealthy husbands and wives who have ample additional means or who for other reasons do not covet each other's property could rarely be found to have set up such trusts in order to induce or pay for each other's transfer. And Congress could hardly have believed that the rule it approved would apply only to those husbands and wives who are sufficiently estranged so as to bargain with each other at arm's length or who set up reciprocal trusts because they are motivated to acquire each other's property.

If the economic effect of the transfers is to leave the value of the husband's estate undiminished to the extent of the value of what he received, the decedent's motives for his actions must be immaterial for purposes of determining the value of his taxable estate. To permit the applicability of Section 811(c)(1)(B) to turn on the ascertainment of the motives of the deceased reciprocal donors—here motives for actions taken more than 35 years ago—is to substitute an impractical subjective test for the objectively workable test demanded by the statute. In the words of Professor Lowndes (*Consideration and the Federal Estate and Gift Taxes,* 35 Geo. Wash. L. Rev. 50, 80 (1966)):

> If, as a result of transfers by related taxpayers, a transferor ends up in exactly the same posi-

> tion as he would have been if he had made a taxable transfer, there is no obvious equity in treating him as though he made the transfer in which he acquired a taxable interest. * * * a "net effects" test is * * * the only genuine test which can be applied to * * * transfers by related taxpayers. A "consideration test" based upon the unknown and unknowable state of mind of the transferors is sheer fiction; it is no test at all. * * *[17]

C. THE AUTHORITIES RELIED ON BY THE COURT OF CLAIMS WERE WRONGLY DECIDED TO THE EXTENT THEY SUPPORT THE DECISION BELOW

The Court of Claims distilled its "consideration-motivation" test from (R. 59–60) *In re Lueders' Estate*, 164 F. 2d 128 (C.A. 3) and *Newberry's Estate* v. *Commissioner*, 201 F. 2d 874 (C.A. 3).[18] Those cases, to be sure, do suggest that the subjective motivation

[17] See, also, Lowndes and Kramer, *Federal Estate and Gift Taxes* (2d ed. 1962) pp. 195–196.

[18] The court also relied on *McLain* v. *Jarecki*, 232 F. 2d 211 (C.A. 7). As we have noted above (p. 20 n. 10), that case no longer represents the position of the Seventh Circuit.

The majority also cited *Tobin* v. *Commissioner*, 183 F. 2d 920 (C.A. 5). There the question was whether a husband and wife should be taxed during their lives on the income produced by trusts that each had established by instruments directing the accumulation of income until an advisory committee directed its payment to the spouse of the settlor. *Tobin* was thus an income tax case involving a different statutory provision. There was no question of an income escaping taxation, and the taxpayer-husband had renounced his right to share in the trust income. The court did not discuss its reasons for holding the "reciprocal trust rule" inapplicable but merely said that in the circumstances (183 F. 2d at 921) "the *Lehman* case in no wise requires a holding that the trusts were reciprocal."

of the settlors is relevant—*i.e.,* that the trusts should be uncrossed only if each settlor subjectively *intends* to provide consideration for the other's transfer. However, the factors we have discussed above (pp. 20–34) establish the error of such an analysis, which applies a subjective motivation test taken from the law of trusts or contracts rather than the rule of substance over form that has been the hallmark of the application of the Internal Revenue Code. As the Eighth Circuit stated in *Guenzel's Estate* v. *Commissioner, supra* (258 F. 2d at 254), these decisions err in approaching the problem only "from a trust standpoint," while the "real basis" for the *Lehman* line of cases is that each transferor has retained " 'equivalents" and "the substance of full enjoyment of all the rights [for life] which previously he had in the property'." In addition, *Newberry's* Estate makes no mention of the Congressional intent reflected in the enactment of the 1949 relief legislation and the committee reports thereon.[19]

Nor is it at all clear that these decisions support the Court of Claims decision here, once their facts are analyzed. In *Lueders' Estate,* a husband and wife, 15 months apart, each created a trust, giving the other a life estate and power to terminate in favor of the beneficiary.[20] The two trusts had not been

[19] *In re Lueders' Estate, supra,* was decided in 1947.

[20] Apparently following its own prior decision (reversed subsequently by this Court) that even a life estate retained by the transferor would not subject the decedent's property to estate tax (*Commissioner* v. *Church's Estate,* 161 F. 2d 11 (C.A. 3), reversed, 335 U.S. 632), the court considered the issue without regard to the life estate received by Mrs. Lueders.

created as parts of a single transaction and there was no suggestion that the wife had agreed to make her transfer on account of the husband's. The Third Circuit reversed the Tax Court decision that the powers to terminate were reciprocal, holding that there was an absence of consideration under the law of contracts. However, it distinguished *Cole's Estate and Hanauer's Estate* on the ground that the trusts there (as here) were executed essentially at the same time, and did not express disagreement with these cases.

In *Newberry's Estate* v. *Commissioner, supra,* the husband and wife had each transferred property irrevocably in trust for their children at about the same time. Although they had *not* created life estates for each other, each gave the other the power to shift beneficiaries among their issue, spouses of issue, and charities, a power which neither in fact exercised. Because of the power, upon the death of the wife the Commissioner included the husband's trust in her estate under authority of Section 811(d)(2) of the 1939 Code, as a transfer with a reserved power to alter or amend (201 F. 2d at 876). The Third Circuit, however, accepted the surviving husband's testimony that they had given each other the powers only out of a fear that some "schemers or ne'er-do-wells" might marry their children and obtain control of the funds. The court's statements that (201 F. 2d at 877–878) a subjective intent to give consideration is required seemed to be confined to situations where the parties granted to each other limited powers which were not actually exercised, a substantially different circum-

stance than here, where life estates were granted and enjoyed.[n]

D. THE DECISION BELOW CANNOT STAND EVEN WITHIN THE CONTEXT OF THE COURT OF CLAIMS' SUBJECTIVE MOTIVATION TEST

Even assuming *arguendo* the correctness of the Court of Claims' own test of subjective motivation, the undisputed facts demonstrate that its decision should be reversed. Central to the majority's conclusion that there was no mutual bargaining by the decedent and his wife was its emphasis upon the fact that there was (R. 70; and see also 102) "no evidence in the record that Janet Grace even knew about the creation of the Joseph Grace trust by the decedent." However, such an analysis overlooked Janet Grace's entirely passive role in the family financial decisions. She relied upon her hus-

[n] Compare *McNichol's Estate* v. *Commissioner*, 265 F. 2d 667, 670 (C.A. 3), certiorari denied, 361 U.S. 829. That case cited with approval *Orvis* v. *Higgins*, *supra*, *Cole's Estate* v. *Commissioner*, *supra*, and *Moreno's Estate* v. *Commissioner*, *supra*, in holding that a decedent's estate must include property he put in an inter vivos trust nominally for the benefit of his children, but with an oral understanding that the decedent would receive the income for his life. It stated those cases "hold that when two persons separately create equivalent trusts simultaneously, with income payable from each trust to the settlor of the other, the property transferred by each settlor is nevertheless subject to § 811 (c) (1) (B)," of the 1939 Code.

See, also, *Estate of Newberry* v. *Commissioner*, 172 F. 2d 220 (C.A. 3), affirming *per curiam* decision of April 30, 1947 (P-H Memo T.C., par. 47, 113); *Estate of Oliver* v. *Commissioner*, 148 F. 2d 210 (C.A. 3), affirming *per curiam* decision of April 28, 1944 (P-H Memo T.C., para. 44,138). Both held that simultaneous trusts with crossed life estates should be treated as transfers retaining life estates, without any discussion of whether or not one induced the other.

band for all business judgments and decisions (see, *e.g.*, R. 62–63, 70, 88, 92, 98, 100–101, 102; Findings 5(a), 10, 12(a), (b), (e)), including a willingness to transfer property for his benefit (R. 70) "merely because the decendent requested that she do so". Surely then, decendent was, at the least, the agent of his wife with complete authority to act on her behalf in financial and business matters, including the creation of the reciprocal trusts. What Janet Grace might or might not have thought or done in 1931 is of no importance, since it is clear that she would have done whatever her husband asked.

Accordingly, the proper focus of the inquiry should not hinge upon the existence of negotiations between the decedent and his wife but upon the decedent alone and what *he* did. He had two roles. He was acting on his own behalf and he was also acting for his wife, in financial affairs generally and with respect to the reciprocal trust in particular.

Even under the Court of Claims' theory, the burden of proving lack of bargaining is the taxpayer's and not the government's. See *Orvis* v. *Higgins, supra*, 180 F. 2d at 541; *Estate of Eckhardt* v. *Commissioner*, 5 T.C. 673, 680. At the least, therefore, respondents had to prove an absence of intent to provide consideration. Thus they had to prove that Joseph Grace did not intend that the trust he had his wife establish for his benefit would be a *quid pro quo* for the trust he established for her benefit.

The evidence, however, all points the other way. The Court of Claims found that decedent was willing to put into the trust for Janet's lifetime benefit (R.

116) "all the properties of value which he still had and which were of such a nature that they would be suitable" for such a trust. It was all planned and executed as part of a single transaction (R. 122-123). There is no basis in the evidence or the findings for an inference that he did not consider it important to obtain the right to possession and enjoyment of Tullaroan (including the right to its sale and reinvestment of the proceeds for his benefit) and the income from her securities as a necessary offset to the stripping of his own assets. It defies reality to hold on this record that consideration was not intended.

Nor is it enough, as the Court of Claims said (R. 71) to await proof of a tax avoidance motive to find adequate evidence of "consideration." Section 811 and its counterparts in the 1954 Code—except those involving gifts made in contemplation of death—all turn on the nature and on the effect of a given transaction and not on the decedent's motive. To make the result depend on proof of or the absence of proof of tax motivation—which is hardly ever proclaimed—would depend upon the haphazard availability and amorphous recollection of witnesses as to the state of mind of decedents many years earlier (here more than 35 years).

At all events, the evidence that decedent was motivated by the desire to avoid estate tax as well as gift tax [22] is particularly strong. No other rational purpose was shown for his causing his wife to transfer the life interest in an estate on which he expected to and

[22] See R. 92, 116; R. 70, 74; Op. 12, 16.

did live for the rest of his life (R. 101; R. 69), and which he could have obained from his wife at any time merely for the asking (R. 70).[23] In addition, in 1931 a Grace National Bank trust officer, Alan Ross was promoting reciprocal trust plans as a tax avoidance device among various officials of the bank and its parent company, W. R. Grace & Company, of which the decedent was board chairman. The plan was put into effect for that purpose by D. Stewart Iglehart, a personal friend of decedent and president of W. R. Grace & Company. Thereafter, although he had never previously made gifts with retained or crossed life estates, Joseph Grace, who was shown to have expressed interest in the effectiveness of Ross's plan for estate tax purposes, approached his trust adviser at W. R. Grace & Company with a draft or drafts of trust instruments for his use, copied from Iglehart's trust and prepared for Ross's signature on behalf of the Bank as trustee (R. 3-8). Neither Ross nor the Bank had ever previously handled decedent's family affairs. (R. 110-118; see, also, R. 77-79).

The majority's statement that (R. 71) decedent never said or did anything which would indicate or imply motivation to avoid estate tax wholly disregards this evidence. The only reason which it expressly states for its inference that (R. 73) "Joseph

[23] For example, "on March 31, 1929, Mr. Grace had Mrs. Grace retransfer to him * * * shares of stock * * * having a book value of $613,444.32" (R. 110); and on January 27, 1932, decedent had Janet return to him $173,434 in book value of assets in the Joseph trust, only four months after he created it. See p. 5 n. 5, *supra*.

Grace * * * was not attempting to carry out the Ross plan to minimize estate taxes" in making his family dispositions in the manner he did is that (R. 73)—

> Mr. Grace created the Joseph Grace trust on December 15 and caused Mrs. Grace to create the Janet Grace trust 15 days later, whereas an essential part of the Ross plan to lessen estate taxes was the lapse of a considerable period of time between the creation of trusts by a husband and wife.

All this proves, of course, is that decedent may have been less cautious than Ross or was unwilling to subject himself or his wife to possible reenactment of the gift tax if he waited until 1932. (R. 92, 116).[24]

The Court of Claims did suggest that decedent established his trust as (R. 74) "another step in a long-established pattern of family giving". But decedent's trust departed entirely from that so-called "long-established pattern" because it and his wife's trust were parts of (R. 122–123) "essentially a single transaction", and were not direct gifts from decedent to his wife or children. The subjective motivation underlying these trusts, if that be relevant, simply cannot be determined in disregard of the reciprocity that constituted their most distinguishing feature. If decedent's motive was not tax avoidance, nothing in

[24] The court does not mention in its opinion that Iglehart also disregarded Ross' cautionary advice to him about spacing the two trusts sufficiently far apart as to avoid the appearance of a single plan. (R. 113–115). Nor does it note the 1949 congressional committee reference to the fact that generally reciprocal trusts by husband and wives were created at about the same time. (See p. 23, *supra*.)

this record discloses what did in fact prompt him to arrange his and his wife's virtually simultaneously transfers for each other's benefit, all as part of one transaction.

CONCLUSION

The decision of the Court of Claims should be reversed and the case should be remanded for further proceedings.[25]

Respectfully submitted.

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JANUARY 1969.

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[25] If the decision below is reversed, the Court of Claims must decide respondents' contention going to the value of the resulting addition to decedent's estate.

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In the

Supreme Court of the United States

OCTOBER TERM, 1968

No. 574

UNITED STATES,
Petitioner,
v.
ESTATE OF JOSEPH P. GRACE, Deceased, et al.,
Respondents.

On writ of certiorari to the United States Court of Claims

BRIEF FOR RESPONDENTS

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UNITED STATES,

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ESTATE OF JOSEPH P. GRACE, Deceased, et al.,

Respondents.

On writ of certiorari to the United States Court of Claims

BRIEF FOR RESPONDENTS

JURISDICTION

Respondents contend that the Court lacks jurisdiction of this case for the reasons stated in their brief in opposition to the petition for a writ of certiorari.

QUESTION PRESENTED

Whether the value of property, consisting of the family homestead and stock furnishing enough income to pay the annual real estate taxes thereon, transferred by the decedent's wife in trust giving the decedent a possessory life estate therein, was properly excluded from the decedent's gross estate because it was not property of which the decedent had at any time made a transfer under which he retained a life estate, within the meaning of Section 811 (c) (1) (B) of the Internal Revenue Code of 1939 applied in the light of the "reciprocal trust doctrine", notwithstanding that fifteen days earlier the decedent had transferred various commercial investment properties in trust under which income was payable to his wife for her life, where the facts were found to be: that although the two trust instruments were similar in form, the purposes, practical and economic effects, character and function of each trust were entirely different from those of the other trust; that the two trusts were not created to avoid estate taxes but merely as another step in a long-established pattern of family giving; and that the decedent's transfer in trust and his wife's transfer in trust were each made gratuitously and not in consideration of or reciprocation for the transfer of the other.

STATUTES INVOLVED

Section 811, Internal Revenue Code of 1939 (26 U.S.C., 1939 Code, §811):

"SEC. 811. GROSS ESTATE.

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible, or intangible, wherever situated, except real property situated outside of the United States—

"(c) * * * (1) GENERAL RULE.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * *

"(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

* * *

"Subparagraph (B) shall not apply to a transfer made before March 4, 1931; nor shall subparagraph (B) apply to a transfer made after March 3, 1931, and before June 7, 1932, unless the property transferred would have been includible in the decedent's gross estate by reason of the amendatory language of the joint resolution of March 3, 1931[1] (46 Stat. 1516).

[1] The joint resolution, expressly made applicable to the transfer involved in the present case by this provision, is reproduced immediately below.

* * *

"(d) * * * (2) TRANSFERS ON OR PRIOR TO JUNE 22, 1936 — To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth * * *."[1]

Joint Resolution of March 3, 1931 (c. 454, 46 Stat. 1516):

"RESOLVED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE UNITED STATES OF AMERICA IN CONGRESS ASSEMBLED, That the first sentence of subdivision (c) of Section 302 of the Revenue Act of 1926 is amended to read as follows:

(c) To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment

[1] Section 302(d) of the Revenue Act of 1926 (c. 27, 44 Stat. 9-131) as originally enacted and as in effect in December, 1931, contained the identical language of Section 811(d)(2), above, except that the caption, making this language applicable only to transfers on or prior to June 22, 1936, was not contained in the original 1926 Act. Section 805 of the Revenue Act of 1936 (c. 690, 49 Stat. 1744) amended this provision, but specifically provided in subsection (b) that the amended language was not applicable except in case of transfers made after June 22, 1936, the date of enactment of the Revenue Act of 1936. The Congress, in enacting the Internal Revenue Codes of 1939 and 1954, deliberately preserved this dichotomy to prevent retroactive application of the 1936 amendment, by providing separate paragraphs applicable respectively to transfers *after* and *before* June 22, 1936 (Section 811(d)(1) and (2) of the 1939 Code and Section 2038(a)(1) and (2) of the 1954 Code). Thus, with respect to the transfer in trust involved in the present case, where the transfer was made in 1931, the applicable statutory language has remained unchanged from 1926 to the present time.

at or after his death, (including a transfer under which the transferor has retained for his life or any period not ending before his death:

(1) The possession or enjoyment of, or the income from, the property, or

(2) The right to designate the persons who shall possess or enjoy the property or the income therefrom,

except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

STATEMENT

1. Nature of the Controversy.

This is a suit to recover an estate tax deficiency and interest thereon collected from respondents on July 14, 1954, based on an adjustment made by the Internal Revenue Service adding to the decedent's gross estate the assets of a certain trust (herein called the "Janet Grace trust"), with the following explanation:

> Represents reciprocal trust made by decedent's wife, Janet, on Dec. 31 [sic], 1931, for the benefit of decedent. Includible in the gross estate under Section 811(c) of the Internal Revenue Code. A full explanation of this adjustment was given to the estate representatives. (Finding 24, R. 107.)

A timely claim for refund was filed, based on the contention that the Janet Grace trust was not a reciprocal trust and was not includible in the decedent's estate (Finding 25, R. 108). This suit followed.

Section 811(c) of the Internal Revenue Code of 1939, under the authority of which the Internal Revenue Service

purported to act, provided that the value of the gross estate of a decedent should be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, "To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * the possession or enjoyment of, or the right to the income from, the property * * *." (Op. 2, R. 57.)

It is clear that under the provisions of the Janet Grace trust, the decedent for his lifetime had the right to the income from the income-producing portion of the trust property, and that he was entitled to the possession and enjoyment of the remainder of the trust property. On the other hand, the decedent, at least in form, was not the settlor of the trust, he had not directly "made a transfer" of any property or interest in property to the trust, and, strictly speaking, he had not "retained" any beneficial interest in the trust property but, rather, had obtained such interest by virtue of the instrument creating the trust. The person who executed the instrument creating the trust of December 30, 1931, and who directly transferred to that trust all the property covered by it, was the decedent's wife, Janet Grace (hereinafter sometimes called "Janet"). (Op. 2-3, R. 58.)

The defendant (petitioner) contended in the court below that the decedent, by himself creating on December 15, 1931, a reciprocal trust which conferred on Janet Grace benefits

similar to those which were conferred on the decedent by the Janet Grace trust, furnished consideration for the creation of the Janet Grace trust; and, therefore, that for estate tax purposes the decedent and Janet should be switched or crossed as settlors and the decedent should be regarded as having been in substance the settlor of the Janet Grace trust. This contention was based upon a judicially developed rule that was first announced in the case of *Lehman v. Commissioner*, 109 F. 2d 99 (2d Cir. 1940), cert. den. 310 U.S. 637. (Op. 3, R. 58.)

II. The Janet Grace Trust.

On December 30, 1931, Janet executed the trust instrument creating the Janet Grace trust (Finding 12(a), R. 98) and transferred it to the family homestead property, known as "Tullaroan", and 40 shares of stock in a corporation known as "Lundy's Lane Corporation" (Finding 12(b), R. 101).

Tullaroan was a large country estate (approximately 167 acres) located on Long Island, which was occupied by the decedent and his wife as their family homestead, beginning about 1911 and continuing thereafter as long as each of them lived (Finding 6(a), R. 89).

Janet had owned the Tullaroan property since April 5, 1911, when the decedent acquired title for her and paid the purchase price as a gift to her; thereafter, the decedent had made additional gifts to his wife by payment of the costs of construction of buildings and improvements on her prop-

erty, and his uncle paid for substantial additions to the main residence in about 1920 (Finding 6(b), R. 89). The improvements on Tulloroan included a 65-room mansion with various auxiliary buildings and improvements (Finding 6(a), R. 89). The latest improvement on the property had been an indoor tennis court building completed in 1926 at a cost of $97,725.97 (Finding 7(a), R. 90).

The gift of the 40 shares of Lundy's Lane Corporation stock to the Janet Grace trust was merely an adjunct to the transfer of Tullaroan in trust. The express purpose of placing these shares in trust with the homestead was to furnish annual dividend income in the amount required to pay ad valorem taxes on Tulloroan (Finding 45(d), R. 116). Lundy's Lane Corporation had been incorporated on November 9, 1923, by Janet to hold certain securities which she had received as gifts from the decedent at various times during the years 1917, 1918, 1919 and 1922. All of its capital stock (607 shares) was originally owned by Janet. She never made any transfer or disposition of any of such shares except by gifts to her husband and children. She made a gift of 200 shares to the decedent on March 31, 1929, of which the decedent made gifts of 100 shares to trusts for his five children on April 4, 1930 (Finding 12(d), R. 101). On December 30, 1931, she made the gift of 40 shares, out of the 407 shares she then owned, to the Janet Grace trust (Finding12(b), R. 100). She gave 2 shares to a trust for one son in 1935 and 2 shares to the other four children in 1937 (Finding 17, R. 104). At the time of her death on Decem-

ber 31, 1937, Janet still owned the remaining 363 shares of Lundy's Lane Corporation, which were included in her taxable gross estate (Pl. Ex. 34, Sheet 24, Schedule B, Item II).

There was no change whatever in the use and enjoyment of the homestead by the decedent, Janet, and their children as a result of the transfer of legal title from Janet to herself and her co-trustees as trustees of the Janet Grace trust. At the time of creation of the trust, neither the decedent nor Janet ever expected to leave Tullaroan during their lives; and, in fact, both continued to live there until they died. (Finding 12(c), R. 101.)

Under the provisions of clause *First* of the trust instrument creating the Janet Grace trust, Janet expressly retained the power as trustee to change the enjoyment of the property she had transferred to the trust through the exercise of a power, in conjunction with either one of the other two trustees, to alter, amend or revoke her transfer by distributing outright to the decedent during his life "any amounts of the principal of said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time deem advisable" (Finding 12(a), R. 98-99). Janet Grace retained that power of revocation as one of the trustees of the Janet Grace trust until her death (Finding 19, R. 104).

III. The Joseph Grace Trust.

The decedent, on December 15, 1931, had created a trust, hereinafter called the "Joseph Grace trust" (Finding 11(a), R. 92). The decedent on December 15, 1931, transferred to himself and two others as trustees of this trust all of his minority interest (20% to 25% in each case) in three real estate development enterprises, Gilchrest Realty Corporation, Belgrave Realty, Inc. and Grace Harbor joint venture; two unimproved tracts of land, Yaphank (about 1,000 acres) and Bell-Brookhaven Lot 26 (3.6 acres); buildings in New York City known as 310-312 East 37th Street; a rental cottage called Thomaston Cottage No. 5; and 150 shares (out of 760 shares then outstanding, all of which were owned by the decedent) of a personal holding company known as Thomaston Corporation (Finding 11(b), R. 94-95. The shares of stock of Gilchrest Realty Corporation and Belgrave Realty, Inc., the one-fourth interest in Grace Harbor joint venture, and Thomaston Cottage No. 5 had all been received by the decedent by means of gifts and inheritances, while the Yaphank, Bell-Brookhaven Lot 26, and 310-312 East 37th Street properties had been purchased by the decedent as speculative investments in 1926 and 1928 (Findings 11(c), (d), (g) and (h), R. 95-97).

In transferring these properties to the Joseph Grace trust, the decedent, as a trustee of his trust, retained under the express terms of the trust instrument the power to change the enjoyment of the trust property through the exercise of a power, in conjunction with either one of the other two

trustees, to pay to Janet "any amounts of the principal of the said trust, up to and including the whole hereof, which the said Trustees or a majority of them may at any time or from time to time in their sole discretion deem advisable" (Finding 11(a), clause *First*, R. 93). By the exercise of this power, the decedent could effectively terminate the trust and thereby alter, amend or revoke his transfers of the properties at any time while the trust continued in existence. He elected to revoke his transfer of the 150 shares of Thomaston Corporation only four months after the transfer by distributing those shares on April 27, 1932, to Janet, who donated them back to him on the same day (Finding 11(e), R. 96).

The duration of the Joseph Grace trust was "during the life of my wife, Janet Grace", and by its provisions it terminated and was to be distributed "upon the death of my said wife" (Finding 11(a), clauses *First* and *Second*, R. 93). Janet Grace died on December 31, 1937, at the age of 53 years (Finding 18(a), R. 104), and by its terms the Joseph Grace trust then expired. The decedent died in 1950, at the age of 73 years (Finding 22, R. 107), about 13 years after the Joseph Grace trust terminated.

IV. Background and Events Leading to Creation of Trusts.

The transfers of property by Janet and the decedent to the Janet Grace trust and the Joseph Grace trust, respectively, were made in continuation of, and as another step in, a long-established pattern of family giving which

began as early as 1911, continued for many years, and which involved numerous transfers of valuable property and financial interests among the members of the family (Op. 11, 12, and 16, R. 68, 69 and 74). The pattern of creating trusts for the benefit of members of the family and of transferring assets directly to members of the family continued during the years that followed the creation of the Joseph Grace trust and the Janet Grace trust in December of 1931. Both the decedent and Janet were involved in such actions (Op. 9, R. 66).

This pattern commenced with the decedent's original gift of Tullaroan to Janet and his subsequent donation of the cost of substantial improvements thereon (Finding 6(a) and (b), R. 89). Substantial gifts of valuable properties by the decedent to or for his wife and children were shown to have been made on one or more (often several) occasions during each year (excepting only 1921 and 1924) from 1917 through 1930. These included 24 transfers of property and financial interests by the decedent to Janet from 1917 through 1929, as well as 26 transfers in trust for the benefit of his children from 1920 through 1930 (Op. 5-6, R. 61-62; Findings 7 and 8, R. 90-91).

Although Janet had no wealth or property of her own at the time of her marriage to the decedent, and did not thereafter inherit any substantial wealth, as a result of his generousity, she ended up having approximately as much

wealth as he did (Findings 4, R. 88, and 31, R. 109-110). The capital account on her books showed a net worth at book value of $3,633,133.26 on December 31, 1931, after the creation of the Janet Grace trust (Finding 14, R. 102). At the time of her death in 1937, the capital account on her books showed a net worth at book value of $3,550,131.04, and her gross estate (excluding the Janet Grace trust) was valued for Federal estate tax purposes at a total value of $5,550,481.78 (Finding 18(b), R. 104).

Janet, although more often the recipient of the decedent's generosity, had also participated in the pattern of gifts to family members. The record contains evidence concerning five instances during the period from 1920 through 1929, when Janet made transfers of assets to or for the benefit of the decedent or their children (Op. 6, R. 62; Finding 9, R. 91).

The events that led directly to the creation by the decedent of the Joseph Grace trust and to Janet's transfer of property to the Janet Grace trust began in the early part of December, 1931, when the decedent conferred with J. Morden Murphy, head of the Customers' Securities Department of W. R. Grace & Co., whose services he used to assist him in managing the properties and business affairs of the family, including property and financial interests owned by Janet. The decedent believed that a new gift tax would

probably be enacted and become effective early in 1932,[9] and he was anxious to carry out promptly the creation of additional trusts by him and Janet for the benefit of the family, in furtherance of their long-established pattern of family giving, prior to the close of 1931 in order to avoid paying the anticipated gift tax in connection with transfers of assets to such trusts (Op. 7, 11, 12 and 16, R. 63, 68, 69-70 and 74; Findings 15, R. 102, and 45(e), R. 116).

Although there is no direct evidence in the record relative to the circumstances that were involved in the transfers of assets by Janet, the court below considered that "it is reasonable to infer that such transfers were made by Janet Grace in accordance with plans devised by the decedent" (Op. 7, R. 63). Generally, Janet did not concern herself with business matters but relied upon the decedent to manage her property and financial interests. Trusting in his wisdom and benevolence, she customarily followed his suggestions, advice, recommendations or requests with reference to disposition of her properties, even when gifts by her to the decedent were involved (Op. 6-7, 12, R. 62-63 and 70; Findings 5(a), R. 88, and 31, R. 110).

[9] The gift tax law was enacted by Congress in the following session and became effective on June 6, 1932, Sec. 501, et seq., Revenue Act of 1932 (c. 209, 47 Stat. 169-289). Prior thereto, a gift tax had been levied by Sections 319-324, Revenue Act of 1924 (c. 234, 43 Stat. 253-355), and amended by Section 324 of the Revenue Act of 1926 (c. 27, 44 Stat. 9-131). The 1924 Act, enacted June 2, 1924, was retroactively applicable to all gifts made during the calendar year 1924. The 1926 Act retroactively reduced the gift tax rates under the 1924 Act, and made the gift tax as reduced applicable only to gifts during the calendar years 1924 and 1925, in effect repealing the gift tax for 1926 and subsequent years. From that time until the Revenue Act of 1932, there was no gift tax. Therefore, when the trusts here involved were created in December, 1931, there had been no gift tax for about six years.

The decedent initiated the idea of the Janet Grace trust and made all the arrangements for preparation of instruments; she did not participate in the planning or preparation of the Janet Grace trust, but created that trust upon the recommendation of the decedent pursuant to plans and arrangements initiated by him (Findings 5, 10 and 12(a), R. 88, 92 and 98; Op. 12, R. 70). There is no basis in the record for a finding that Janet Grace, in transferring Tulloroan and 40 shares of stock to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust. Indeed, there is no evidence in the record that Janet, when she created the Janet Grace trust, even knew about the creation of the Joseph Grace trust by the decedent. On the basis of the whole record, the Court of Claims considered it reasonable to infer that Janet executed the instrument creating the Janet Grace trust and transferred property to that trust merely because the decedent requested that she do so (Op. 12, R. 70; Finding 12(e), R. 102).

In connection with the Joseph Grace trust and the Janet Grace trust, neither the decedent nor Janet had any desire to acquire property from the other (Finding 15, R. 102).

The Joseph Grace trust and the Janet Grace trust were not created, and properties were not transferred to these trusts, pursuant to any agreement, express or implied, between the decedent and Janet to make reciprocal transfers of properties (Finding 29, R. 109).

The transfer of property by the decedent to the Joseph Grace trust was not in consideration of the transfer of property by Janet to the Janet Grace trust; and the transfer of property by Janet to the Janet Grace trust was not in consideration of the transfer of property by the decedent to the Joseph Grace trust (Finding 30, R. 109).

V. Remand Proceedings in the Court Below.

On July 20, 1964, Trial Commissioner Mastin G. White submitted an opinion, findings of fact and recommended conclusions of law (30 printed pages), based on the evidence accumulated in elaborate pre-trial submissions, trial in New York City in the latter part of 1963 (565 transcript pages), proposed findings and objections thereto and exhaustive briefs on behalf of both parties, and a thorough and painstaking review, analysis and evaluation of the evidence of record by the Trial Commissioner. The findings of fact submitted with the Trial Commissioner's report of July 20, 1964 (R. 9-38) consisted of Findings 1 through 30, inclusive, as ultimately adopted by the Court of Claims and incorporated in its decision (R. 87-109).

Upon review of the first report of the Trial Commissioner, after submission by both parties of exceptions to the Commissioner's recommendations, extensive printed briefs (255 pages) and formal oral argument before the five Judges, sitting *en banc*, the Court of Claims remanded the case to the Trial Commissioner. Being unable to offer any convincing opposition to the factual conclusion that the two trusts

involved in this case were not created in consideration of each other, the Government's brief and argument were instead grounded upon the theory that the "reciprocal trust doctrine" should be applied in this case to frustrate a scheme designed to avoid estate taxes, asserting that tax-avoidance purposes should be assumed to exist on the basis of alleged facts not shown by the record. Apparently being convinced by the Government's argument that tax-avoidance motives were controlling, yet unwilling to assume without proof the disputed allegations, a majority of the judges[4] of the Court of Claims issued an order dated March 25, 1966 (R.39), remanding the case to the Trial Commissioner for a further hearing on the question: —

> "* * * whether the decedent was motivated in the setting up of the Joseph Grace and the Janet Grace trusts, in December 1931, by the desire to avoid or lessen estate taxes."

After a further trial in which additional testimony (to the extent of 430 transcript pages) was received, and numerous additional documentary exhibits were admitted in evidence, and after additional proposed findings and objections thereto and exhaustive briefs were submitted on behalf of both parties, and after the Trial Commissioner thoroughly reviewed, analyzed and evaluated the entire record, a Supplemental Report of Commissioner to the Court was filed on February 23, 1967 (R. 41-55). It contained additional Findings 31 through 53 (R. 109-123), including the following

[4] Chief Judge Cowen dissented. A motion for re-hearing filed by plaintiffs (respondents) was denied, with Judge Collins dissenting.

conclusion of fact in direct response to the question raised in the Court's remand order (Finding 52, R. 122):

> "52. The evidence in the record does not indicate that Joseph P. Grace was motivated by the desire to avoid or lessen estate taxes in the setting up of the Joseph Grace trust and the Janet Grace trust in December 1931."

The Court of Claims' opinion amplifies this conclusion as follows (Op. 13, R. 71):

> "It appears from the evidence in the augmented record that Joseph P. Grace never said or did anything which would indicate or imply that he was motivated by the desire to avoid or lessen estate taxes when he created the Joseph Grace trust on December 15, 1931 and caused his wife to create the Janet Grace trust on December 30, 1931. The evidence also establishes the existence of other logical and even compelling motives for these transactions."

And the Trial Commissioner commented in his supplemental report (R. 45):

> "The additional evidence that has been added to the record does not change my original conclusion that Joseph P. Grace, when he created the Joseph Grace trust on December 15 and caused his wife to create the Janet Grace trust on December 30, 1931, was merely continuing a long-established pattern of conduct."

VI. Decision of the Court of Claims.

The majority of the Court of Claims reviewed the terms of the statute (Op. 2-3, R. 57), the leading *Lehman* case (Op. 3-4, R. 58-60), and the numerous cases that have followed and applied it. In the view of the Court, there are

"two lines of cases" or "two divergent views" of the *Lehman* rule, one line holding that whether a decedent is to be treated as settlor of a trust created by another depends upon whether he furnished consideration for the other party's transfer in trust. This, said the Court, is a question of fact which involves an inquiry into the element of motivation (Op. 4, R. 60). A separate line of cases, in the Court's view, applied diffierent legal standards in determining the existence of consideration; they vary somewhat in the statement of the rule, but basically they look at the objective evidence to determine whether trusts created by husband and wife similar to those involved in this case are reciprocal and taxable. (Op. 13, R. 70).

The majority opinion seeks to measure this case by both standards. Because the first line of cases regards the question of the existence of consideration as a factual issue, the Court in seeking to apply that line, analyzed at length all available facts of this particular case, including objective evidence, seeking to assay the relative weight, significance and relevancy which should be attached to all of the available evidence and facts bearing upon the question of whether the decedent's transfer to the Joseph Grace trust was in fact made in consideration for Janet Grace's transfer of property to the Janet Grace trust, or whether her transfer was in reality made in consideration of his. The Court concluded that, factually, neither trust was made in consideration for the other (Op. 4-12, inclusive, R. 60-70).

The Court further measured the evidence in this case against the "separate line of cases" which it deemed to be based upon "objective" evidence. In the view of the Court of Claims, some of these cases hold that consideration will be inferred from the facts that the properties included in the two trusts are of approximately the same amount, that the trusts are created at or about the same time, and that each grantor gives the other a life estate in income, unless such inference is rebutted by clear evidence, citing *Hanauer's Estate v. Commissioner*, *infra*, and *Orvis v. Higgins*, *infra*, as examples (Op. 13, R. 70-71). Measuring the case in those terms, the Court stated:

> "Therefore, if we take the view of those cases which impose the burden on the taxpayer to rebut any inference arising under the circumstances of this case that the Janet Grace trust was created in consideration of the trust previously established by the decedent, we think the burden has been met." (Op. 16, R. 74).

The Court further expressed the view that there are other cases, of which it cites only *Estate of Ruxton*, *infra*, as an example, in which "the presence or absence of a motive to avoid the payment of estate taxes has been an important factor in deciding the application of the 'reciprocal trust' doctrine." Without mentioning any of the evidence favorable to the plaintiffs (respondents) on the question of tax-avoidance motive, the Court very thoroughly analyzed and weighed, in the light most favorable to the Government, the evidence on which the Government relied to establish tax-avoidance motives, and simply found this evidence to

be of insufficient relevancy or probative force, when weighed against all of the other evidence it had heard, to overcome the more compelling conclusion of fact that the two trusts were not created to avoid estate taxes but merely as another step in a long-established pattern of family giving (Op. 13, R. 71, and 15-16, R. 74; Finding 52, R. 122).

SUMMARY OF ARGUMENT

Section 811(c)(1)(B) of the Internal Revenue Code of 1939 authorizes inclusion in the decedent's gross estate of only that property of which the decedent has at any time made a transfer under which he has retained a life estate. Where two persons have each made a transfer of which the other is lifetime beneficiary, each settlor may be taxed as the person who "made a transfer" of the property transferred by the other party, instead of as transferor of the property which he actually transferred, if it is found that the two transfers were made in consideration of each other.

It is the furnishing of a consideration, or *quid pro quo*, by the decedent for the other party's transfer in trust that brings the doctrine into play and constitutes the person who transferred the consideration as the taxable party deemed to have "made a transfer * * * under which he has retained * * *" the rights to which he is entitled under the trust created by the other party.

If the decedent did not, in fact, make a transfer of his own property in consideration for or as a *quid pro quo*

inducing another party to make a trust, even though he has a life estate in property which was transferred to him gratuitously by another person, the property in which he has a mere life estate is not included as part of his gross estate.

The doctrine that a person who furnishes the consideration for the creation of a trust is the settlor for purposes of the estate tax law was first announced in the leading case of *Lehman v. Commissioner*, 109 F. 2d 99 (2d Cir. 1940), cert. den. 310 U.S. 637 (1940). Since then, the rule has been uniformly and consistently applied in numerous cases.

Whenever the evidence has convinced the court that a trust executed by one spouse for the benefit of the other was, in fact, executed in consideration of a trust executed by the other spouse for the benefit of the former, the spouse whose estate tax liability is in question has been held taxable reciprocally as having made a transfer to the trust of which he is life beneficiary.

On the other hand, it is equally well-established that when the evidence indicates that a decedent's transfer in trust was not a consideration or *quid pro quo* inducing his spouse to create a trust for his benefit, the *Lehman* doctrine has been held inapplicable.

As stated in *Estate of Moreno v. Commissioner*, 260 F. 2d, 389, 390 (8th Cir. 1958):

> "The question of whether the doctrine of the Lehman case will be applied — whether the trusts are crossed

or reciprocal trusts — is one of fact. It is simply a question of whether one trust was made in consideration of the other.

The Court of Claims, in the decision under review, correctly applied this principle in accordance with all of the preceding decisions, and as expressly recognized and approved by Congress when it enacted the Technical Changes Act of 1949, and as also recognized and applied by the Internal Revenue Service for many years.

On the basis of detailed findings made after a thorough analysis of all evidence submitted at two full trials, including numerous documentary exhibits as well as a large amount of verbal testimony, the Court of Claims concluded that the decedent's wife, Janet, had not created the Janet Grace trust, of which the decedent was lifetime beneficiary, in consideration of any transfer of property by the decedent, and that when the decedent made a transfer of his property in trust fifteen days earlier, he had not furnished a consideration or *quid pro quo* for the creation of the Janet Grace trust by his wife. This conclusion of fact required a decision in favor of the respondents in accordance with the established principles of law.

Contrary to petitioner's assertions, the term "consideration" has no narrow technical or peculiar meaning in relation to the *Lehman* doctrine, but is used in its commonly understood sense.

The Court of Claims, in its decision here under review, properly applied the consideration test and found that the decedent's transfer of property to the Joseph Grace trust had not served as a *quid pro quo* effective to bring about his wife's transfer to the Janet Grace trust. This was a correct application of the rule, and the decision should be affirmed.

The trusts involved in this case are not a "prototype" reciprocal trust device. Petitioner's brief is addressed primarily to condemnation of a hypothetical prototype, largely without reference to the actual facts of this case. There was no equivalence of benefits which would allow each party to obtain the same practical economic results as if he or she had transferred his own property to himself for life. Moreover, these trusts could not have been used to carry out the tax-avoidance scheme envisioned by the hypothetical prototype case described in petitioner's brief.

The variously stated proposed rules advocated in petitioner's brief as substitutes for the *Lehman* principle would be wholly inadequate and unworkable. The "net effect" test advocated by Professor Lowndes can only be applied to measure the extent of tax liability of a decedent after it is concluded that he is liable for tax, but offers no standard for determining whether he is liable. All such alternative proposals should be rejected in favor of adherence to the *Lehman* doctrine which has proved the satisfactory test that has been uniformly applied by the courts for three decades.

The issue involved in this case is primarily a factual issue, and the well-founded factual conclusions of the trial court should not be disturbed.

Since the issue as presented to the Court basically calls upon the Court to refind the facts, which was not the purpose for which the writ of certiorari was granted, the writ was improvidently granted and should be dismissed, or else this Court should affirm the decision of the Court of Claims.

ARGUMENT

INTRODUCTION

Numerous cases in the lower courts during the 1940's and 1950's involved the tax consequences of trusts made at the same time by two settlors, under which each was the beneficiary of the trust created by the other. This body of judicial decisions is often referred to as the "reciprocal trust doctrine", and is frequently called the "*Lehman* doctrine". It holds that a person who furnishes the consideration for a trust is the settlor. Although this doctrine arose out of trust law and was first adoped as a rule of tax law in a case that involved reciprocal trusts, the principle involved has various other applications in tax law, as well as other fields of law, including trust law.

Thus, Professor Austin W. Scott has observed, "Where the owner of property gratuitously transfers it in trust, he is the settlor", but "a person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another person." II *Scott on Trusts*, Sec. 156.3 (3rd Ed. 1967); see also, V. *Ibid*, Secs. 423-424. The *Restatement of the Law of Trusts* specifically

comments on the case where a beneficiary may be treated as a grantor because "he paid the purchase price for a conveyance upon a trust, of which he is the beneficiary or one of the beneficiaries." American Law Institute, *Restatement of the Law of Trusts*, Sec. 156, Comment (f), (2d Ed. 1959). These principles have been applied for Federal tax purposes in a variety of situations not involving reciprocal trusts. See, *e.g.*, *Blackman v. United States*, 98 Ct. Cl. 413, 48 F. Supp. 362 (1943).

More specifically, all of the estate tax decisions involving this question have uniformly adhered to the rule that the decedent whose estate is involved will be considered to have "made a transfer" of his property to the trust created by the other party for his benefit, if such trust was created in consideration of a transfer by the decedent of his own property, but not otherwise.

It is the furnishing of a consideration, or *quid pro quo* by the decedent for the other party's transfer in trust that brings the doctrine into play and constitutes the person who transferred the consideration as the taxable party deemed to have "made a transfer * * * under which he has retained * * *" the rights to which he is entitled under the trust created by the other party.

Because it appears to us that the petitioner's brief has not come to grips with the requirement of consideration and its true import in the precedent decisions, we shall find it necessary to review the matter fully.

I. THE DECISION OF THE COURT OF CLAIMS WAS CORRECT.

A. The sole criterion for taxation under the reciprocal trust doctrine is whether the decedent's transfer in trust is a consideration or *quid pro quo* inducing the other settlor to create a trust for decedent's benefit.

The leading authority with respect to the "reciprocal trust doctrine", where the principle was first announced, is the case of *Lehman v. Commissioner*, 109 F. 2d 99 (2d Cir. 1940), cert. den., 310 U.S. 637 (1940), wherein the decedent and his brother, Allan, each owned an equal undivided one-half interest in certain stocks and bonds. The stipulated facts stated, and the Court found that—

> "The decedent agreed to transfer his share in trust for Allan and his issue, *in consideration* of Allan transferring his share in trust for the decedent and his issue." (Italics supplied).

Pursuant to that bargain, the two brothers simultaneously executed trust indentures in which each transferred his undivided one-half interest in trust to pay the income to his brother for life, remainder to the brother's issue, with the right in the brother to withdraw $150,000. The Court held (109 F. 2d, at p. 100):

> "In this case is happened that the trusts were identical, and the case for a tax is the stronger for it; but the outcome would be the same if the decedent had transferred his share outright to his brother. The *decisive point* is that the decedent *by transfer of his share to the brother* or for the brother's use or according to the brother's direction *caused the brother to make a transfer* of property in trust under which the decedent had the right to withdraw $150,000 from principal. While

Section 302(d) speaks of a decedent having *made a transfer* of property * * *, it clearly covers a case where the *decedent by paying a quid pro quo has caused another to make a transfer of property* with enjoyment subject to change by exercise of such power by the decedent. See 52 Harvard Law Review 1015. 'A person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another.' * * * X transfers property in trust for himself for life, with power of revocation. Y goes about it in a slightly different way; he *pays* cash *or transfers* property to another who *in consideration of the cash or property* sets aside or transfers securities in trust for Y for life, with power in Y to terminate the trust and take the principal. Does anyone suppose that X's estate is taxable * * * but that Y's estate is not? Here the transfer by the decedent's brother, *having been paid for and brought about by the decedent*, was *in substance* a 'transfer' by the decedent, and the property so transferred formed part of his taxable estate * * *." (Italics supplied).

To avoid possible confusion, it is important to note at this point that the "cause" which "brought about" the brother's transfer in trust for the decedent's benefit was the *transfer* which the decedent made of his own property. The court said that the "decisive point" of the *Lehman* case was "that the decedent *by transfer of his share to the brother* * * * *caused* the brother to make a transfer * * *." By omitting the relevant portion of that sentence in quoting the *Lehman* case (Pet. Br., p. 17), petitioner's counsel seeks to leave the false impression that the "decisive point" of the *Lehman* case was "that *the decedent* * * * *caused* the brother to make a transfer * * *." However, it was not the decedent's

mere suggestion, recommendation, advice, request, or influence that caused his brother to make a gratuitous transfer for the decedent's benefit — it was the decedent's own *transfer* of his share to his brother that *caused* the brother to make an identical *transfer* to the decedent in consideration therefor.

This relationship of cause and effect between the decedent's transfer of his own property and the rights he thereby obtained in his brother's property is also expressed in the *Lehman* case in the more familiar terms of "consideration" or "*quid pro quo*". The subsequent cases, as shown below, have uniformly adopted this form of expression. The issue of cause and effect is phrased in terms of whether two trusts were created "in consideration of" each other. This consideration test has been uniformly applied in all of the subsequent decisions on the point.

As explained in *Estate of Moreno v. Commissioner*, 260 F. 2d 389, 390 (8th Cir. 1958):

> "The question of whether the doctrine of the Lehman case will be applied — whether the trusts are crossed or reciprocal trusts — is one of fact. It is simply a question of whether one trust was made in consideration of the other."

As with any factual test that is uniformly applied, the *results* of the cases have differed, depending upon the *facts* proved in each case. Opposite facts have produced opposite results. The differing results of the cases are not the result of any conflict or disagreement among the lower courts, but are rather due to distinguishable facts.

Indeed, the apparently "divergent views" noted by the Court of Claims in its opinion below (Op. 4, 13, R. 59, 70), among cases appearing to look at objective evidence with various degrees of conclusiveness, and others more at subjective factors, may be largely due to differences in the evidence before the court in a particular case. A court can only look at the evidence before it, and in some of these cases the record has been very sparse, consisting of stipulated facts. Also, many of the circuit court decisions have been aided by Tax Court findings.

Thus, where the evidence has convinced the court that a trust executed by one spouse for the benefit of the other was, in fact, executed in consideration of a trust executed by the other spouse for the benefit of the former, the spouse whose estate tax liability is in question has been held taxable reciprocally as having made a transfer to the trust created by the other spouse for his benefit. *Estate of Hanauer v. Commissioner*, 149 F. 2d 857 (2d Cir. 1945), cert. den. 326 U.S. 770; *Orvis v. Higgins*, 180 F. 2d 537 (2d Cir. 1950), cert. den. 340 U.S. 810; *Cole's Estate v. Commissioner*, 140 F. 2d 636 (8th Cir. 1944); *Estate of Carter v. Commissioner*, 31 T.C. 1148 (1959); and *Estate of Fish v. Commissioner*, 45 B.T.A. 120 (1941).

On the other hand, it is equally well established that when the evidence indicates that a decedent's transfer in trust was *not* in intent or in effect a consideration or *quo pro quo* inducing his spouse to create a trust for his benefit, the *Lehman* doctrine has been held inapplicable, and the de-

cedent has been held not taxable as having made a transfer to the trust created by his spouse for his benefit, even where the husband and wife have simultaneously executed trusts having identical corpora and identical reciprocal provisions for the benefit of each other. *Estate of Guenzel v. Commissioner*, 258 F. 2d 248 (8th Cir. 1958); *McLain v. Jarecki*, 232 F. 2d 211 (7th Cir. 1956); *Estate of Newberry v. Commissioner*, 201 F. 2d 874 (3rd Cir. 1953), 38 A.L.R. 2d 514; *In re Lueders' Estate*, 164 F. 2d 128 (3rd Cir. 1947); *Tobin v. Commissioner*, 183 F. 2d 919 (5th Cir. 1950), cert. den. 340 U.S. 904; *Commissioner v. McLean*, 127 F. 2d 942 (5th Cir. 1942); *Estate of Ruxton v. Commissioner*, 20 T.C. 487 (1953); *Estate of Resch v. Commissioner*, 20 T.C. 171 (1953); *Welch v. Commissioner*, 8 T.C. 1139 (1947); and *Estate of Lindsay v. Commissioner*, 2 T.C. 174 (1943).

The cases relied upon most heavily by the petitioner are *Estate of Hanauer v. Commissioner, supra; Orvis v. Higgins, supra*, and *Cole's Estate v. Commissioner, supra*. These cases, however, strongly support the consideration requirement and are contrary to the petitioner's theory.

In the *Hanauer* case, the Court of Appeals for the Second Circuit stressed the need to determine whether the decedent's transfer in trust was in fact the consideration or *quid pro quo* that induced and motivated his wife to create the trust for his benefit. Explaining its prior decision in the *Lehman* case, the court reiterated (149 F. 2d, at p. 858):

> "* * * this court held that to the extent that *the decedent's property*, by its transfer in trust, had served as

> *a quid pro quo effective to bring about his brother's transfer*, for purposes of the estate tax the decedent must be treated as the actual settlor under the indenture executed by his brother, — or, in the words of the Act, as the person who had 'made a transfer' in the sense that *by the transfer of his own property* and the consequent impoverishment of his own estate he caused the transfer of his brother's property to be made." (Italics supplied).

The court in *Hanauer* was reviewing a decision of the Tax Court in which it was expressly found as a fact that "Each created his respective trust in consideration of the other. Also, that Carrie H. Hanauer created her trust because her husband, the decedent, created his trust." The court declared (149 F. 2d, at p. 858):

> "We take these findings to mean that the estates created by decedent's trust *served as a quid pro quo for the trust which he caused his wife to make.*" (Italics supplied).

Upon review of the record, the court found "abundant evidence to support those findings". The facts emphasized in the opinion dealt with the "mental attitude of the decedent's wife" and her "knowledge and active participation" in the development and execution of *both* trusts, and her "belief" that the decedent was creating a trust of substantial dimensions. These mental factors pertaining to the wife's *subjective motives and intentions* were relied upon "to support a finding that *her transfer was caused by his.*" (149 F. 2d at p. 859).

In the decision under review, the Court of Claims distinguished the *Hanauer* case because of opposite facts concerning the motivation of the wife, since in the instant case there was no basis in the record for a finding that Janet Grace, in transferring Tullaroan and 40 shares of stock to the Janet Grace trust, was influenced in any way by the circumstance that the decedent had previously created the Joseph Grace trust; and, indeed, there is no evidence in the record that Janet Grace even *knew* about the creation of the Joseph Grace trust by the decedent (Op. 12, R. 70; and see Finding 12(e), R. 102. In *Hanauer*, the wife had created her trust "because her husband, the decedent, created his trust"; in the instant case, on the other hand, the wife had created her trust "merely because the decedent requested that she do so" (Op. 12, R. 70).

In *Hanauer*, the court emphasized that the motivation of the *wife*, and not of the decedent himself, was the crucial test — whether *she* was motivated or caused to transfer her property in trust by his transfer in trust. If the wife's creation of her trust were motivated, induced and caused by the decedent's transfer in trust, then his transfer of property was the consideration or *quid pro quo* for his wife's trust, justifying treatment of him as its settlor. Since the case did not involve the question whether the wife should be treated as settlor of the husband's trust, it was immaterial

whether the wife's transfer had been the motivating cause of the decedent's transfer in trust.[5]

Similarly, in *Orvis v. Higgins, supra*, the Court of Appeals for the Second Circuit recites the facts with reference to conversations which the husband and wife had with their son, their attorney, and each other, indicating a course of bargaining, negotiation and agreement in which the wife was an active particpant, leading to the factual conclusion "that each of those trusts was made in consideration of the other" (180 F. 2d, at p. 540). The opinion also refers to "a case like this, on an issue relating to intention" and states "we find that reciprocal was *intented*" (180 F. 2d, p. 541).

The case of *Cole's Estate v. Commissioner, supra*, most strongly relied upon by petitioner, is somewhat more complex, in that the estates of both husband and wife were before the court in a consideration case. The court advanced alternative grounds of decision — one upholding the Tax Court in taxing each decedent *reciprocally* as settlor of the trust created by the other spouse, and the other holding

[5] The *Hanauer* case also confirms that the question whether one trust was made in consideration of the other trust is purely a question of fact, as to which the results will differ when different facts are found. The court found "no fundamental inconsistency" between the decisions of the Tax Court in that case and in the case of *Estate of Lindsay v. Commissioner, supra*, wherein similar trusts in substantially equal amounts executed by husband and wife at about the same time were held not taxable reciprocally under the *Lehman* doctrine, because the facts as found by the Tax Court indicated that the two trusts "were not made each in consideration of the other" (2 T.C., at p. 179). The Second Circuit pointed out that in both cases "it was within the power of the trier of fact to make its own conclusion from the basic facts", and that "neither due regard for legal principle nor indeed for consistent action required it to make a similar finding upon the different record presented here * * *." (149 F. 2d at p. 859).

that each decedent's estate should be taxed *non-reciprocally* upon "the 300 shares which he himself transferred to the trust created by him" (140 F. 2d, at p. 638). In that case, since both estates were before the court, it made no difference whether each decedent was taxed upon the trust that he himself (or she herself) created or upon the precisely identical trust created by his wife (or her husband). But in the present case it does make a difference whether the decedent is deemed to have been settlor of his own trust or of his wife's trust. Whatever else the *Cole's Estate* case may stand for, it certainly adheres to the requirement of a finding that one trust was made in consideration of the other trust, in order to tax the settlor *reciprocally* as having made a transfer to the *other* settlor's trust. The court construed the findings of the Tax Court to mean that one trust was made in consideration of the other trust, pursuant to an exchange. But assuming that no specific finding of consideration was made, the court made it clear that the respective settlors could not be taxed reciprocally as settlors of each other's trusts.[6]

In *Estate of Guenzel v. Commissioner, supra,* two trusts created by a decedent and his wife on the same day, identical as to form and value, having the same trustee, each naming the other spouse as primary life income beneficiary and himself as secondary life income beneficiary, were held to be not

[6] The *Cole's Estate* case was subsequently clarified and explained by the Eighth Circuit in *Estate of Guenzel v. Commissioner, supra,* where the court explained that the second alternative, regarding each settlor as non-reciprocal transferor to his own trust, was "the real basis for the decision". (258 F. 2d, at p. 254).

taxable reciprocally because of the failure to prove that one trust was in fact created in consideration of the other trust. In arriving at that conclusion, the court relied upon and quoted extensively with approval the cases of *Estate of Newberry v. Commissioner, supra; McLain v. Jarecki, supra;* and *Estate of Ruxton v. Commissioner, supra;* also citing with approval *In re Lueders' Estate, supra* (258 F. 2d, at pp. 251-254). The Court concluded:

> "We have heretofore indicated our view that there was no legal consideration for the creation of the respective trusts. Since there was no bona fide consideration for the establishment of the trusts, no foundation existed for the application of the Lehman doctrine."

Curiously, petitioner claims the *Guenzel* case as supporting its theory (Pet. Br., pp. 19, 28, 35). Yet *Guenzel's* case is obviously in the mainstream of all the cases holding, as does the Court of Claims decision reviewed, herein, that the *Lehman* doctrine is inapplicable when the facts of the case disclose the absence of consideration.

The petitioner also claims that its theory is supported by *Glaser v. United States*, 306 F. 2d 57 (7th Cir. 1962); *Olson v. Reisimer*, 271 F. 2d 623 (7th Cir. 1959); and *Commissioner v. Warner*, 127 F. 2d 913 (9th Cir. 1942). However, none of these cases are in conflict with the Court of Claims decision in the present case. The *Glaser* and *Olson* cases are entirely different—both deal with transfers of jointly owned property in which the decedent retained an interest, and both hold only that the decedent's estate is taxable on his *own* half interest of which he had made a

transfer under which he retained a life interest; neither case held the decedent taxable on his *spouse's* half interest in the jointly owned property. The petitioner's assertion that the latter two cases, which do not even involve the "reciprocal trust doctrine", somehow overruled *McLain v. Jarecki, supra* (Pet. Br., p. 20, fn. 10), is patently absurd. And the petitioner points to nothing in *Commissioner v. Warner, supra*, which is even claimed to be in conflict with the consistent body of law holding that a finding of consideration furnished by the decedent is essential, that case being merely an obvious application of the *Lehman* principle that the person who furnishes the consideration for a trust is its settlor. *Cf. Hill's Estate v. Commissioner*, 229 F. 2d 237 (2d Cir. 1956).

The Tax Court has also consistently applied the consideration test. In *Estate of Carter v. Commissioner, supra*, that Court observed with reference to the principal of the *Lehman* case (31 T.C., at p. 1152):

> "Whether the principle is applicable in a given situation is, of course, dependent upon the particular facts presented. * * * Thus the issue resolves itself into a question of fact, namely whether Ernest and Laura each created his (or her) trust in consideration of the creation of the trust by the other. * * * The question is one of motivations of the two settlors. Their candid testimony might, of course, be the best evidence of their motives in creating the trusts involved. Since they are both dead, we must rely upon other evidence to discern their motivations."

Referring to the cases of *Newberry's Estate v. Commissioner, supra;* and *McLain v. Jarecki, supra,* the Tax Court said in the *Carter* case (31 T.C., at p. 1154):

> "Because the question involved in all reciprocal trust cases is factual, little purpose is served by an extensive discussion of the factual background of each case. As we understand the *Newberry* and *McLain* cases, the decisive test for the application of the *Lehman* doctrine is whether the trusts were executed in consideration of each other. Our treatment of the issue here is consistent with this principle and we do not regard our disposition to be contrary to those cases."

In *Estate of Eckhardt v. Commissioner*, 5 T.C. 673 (1945), a husband and wife executed substantially identical trust instruments for each other's benefit six days apart, the subject matter of each trust being an undivided one-half interest in properties which had been jointly owned by the two settlors. The Tax Court findings clearly supported an inference that an agreement had been entered into between the spouses. Based on the conduct of the parties indicating a course of negotiation and agreement, the Tax Court concluded that "these trusts were executed under such circumstances as would justify the respondent in determining that they were reciprocal and executed in consideration of one another."

In *Newberry's Estate v. Commissioner, supra,* the Court analyzed the *Lehman* case and explained (201 F. 2d, at p. 877):

> "* * * Thus, procedurally, the establishment of 'reciprocal' or 'crossed' trusts was a technical device for realizing the quid pro quo of a bargain.

"The foregoing analysis is important because some of the subsequent cases which apply the Lehman doctrine have stressed the fact that trusts contained 'reciprocal' or 'crossed' provisions without spelling out that this circumstance is significant only to the extent that it may reveal a quid pro quo which another than the named grantor has paid for the creation of the trust in controversey. * * *."

In the *Newberry* case, trusts created simultaneously by a husband and wife having identical crossed provisions and identical assets were held not taxable under the "reciprocal trust doctrine" in the absence of actual proof that the trusts were created as consideration for each other pursuant to a bargain and exchange.

The Court explained the nonsignificance of "interdependence", used in any sense other than to import a bargain for consideration, as follows (201 F. 2d, at p. 877):

"The 'unity' of action of husband and wife and the 'interdependent' character of their transactions * * * are not such circumstances as the *Lehman* doctrine comprehends. Spouses in mutual confidence and common interest work out together what each is going to do with his own money to provide for their children. In the normal case, which this appears to be, it is a distortion of meaning to say that the action of one spouse is a quid pro quo inducing the action of the other. The only 'consideration' is the historic 'consideration of love and affection' for the dependent members of one's family. Similarity of action occurs because each spouse is confident that they together have arrived at a wise and benevolent decision concerning the future welfare of their children. That is all there is to the 'unity' and 'interdependence' of action revealed by such a record as we have here. Neither the substance of the

transaction nor the identity of the actor is revealed as any different from what appears on the face of each trust indenture."

McLain v. Jarecki, supra, confirms the lack of significance of similar language in the trust instruments. There, a husband and wife had each simultaneously executed substantially identical trusts for the benefit of each other for life, prepared by their mutual lawyers. In the absence of proof of a bargain or trade for consideration, nevertheless, the husband's estate was held not taxable on his wife's trust. The Court of Appeals for the Seventh Circuit held (232 F. 2d, at pp. 212-213):

> "The short of *Lehman* is that a person becomes the settlor of a trust *if he supplies the consideration,* in spite of another person's mechanical declaration of the trust. * * * *
>
> "* * * Because the McLains had substantially identical trusts created concurrently and prepared by their mutual lawyers, the government would have us infer *an element of consideration* from which to hold that decedent was the actual grantor of the trust in which his wife declared herself to be the grantor. * * * To reach the inference, *indispensable for the government's position,* would mean compounding probabilities on the subjective impression we have of the objective stipulated facts. * * * *." (Italics supplied).

Similarly, in the case of *In re Lueders' Estate, supra,* where a husband executed a trust for the benefit of his wife for life with power to terminate and withdraw the corpus; the wife fifteen months later created a similar trust of equivalent value for the husband's benefit; and thirty days

thereafter the husband exercised his power to terminate and withdraw the corpus of the trust created by the wife. The two trust instruments contained reciprocal benefits, were both drafted by the same firm of attorneys and "were cast substantially in the same pattern". Notwithstanding the similarity of the trust instruments and the fact that the husband received from his wife securities equivalent to those which he transferred in trust for his wife's benefit, it was held that the trust created by the husband was not taxable as part of his wife's estate under the reciprocal trust theory. The Court declared (164 F. 2d, at pp. 132-133):

> "At the outset it must be stated that the Tax Court made no specific finding either in its finding of facts or in its opinion, that the decedent and her husband had ever *entered into an agreement*, express or implied, to make reciprocal transfers of property. * * *
>
> "Despite the failure to find that there was any *agreement or understanding to make the reciprocal transfers*, and despite the fact that the trusts were created 15 months apart, the Tax Court, in apparent recognition of *the requirement that consideration must be established in order for the Lehman doctrine to become applicable*, concluded in its opinion that there was 'consideration' by a curious series of deductions, which in view of the record itself fail to attain the dignity of factual inferences and can only be described as 'hunches'. * * *."

The Court in the *Lueders* case rejected the Government's contentions that the application of the *Lehman* doctrine "does not depend upon whether decedent furnished legal consideration for the creation of her husband's trust" and that "while the decisions applying the principal speak of 'consideration', this has meant consideration in the sense

that, because of knowledge of the other transfer or of a tacit understanding between the parties, the transfer of the decedent was not an independent act." The Court pointed out that the cases relied upon by the Government did not sustain that contention. (164 F. 2d, at p. 134). After discussing the prior cases, the Court stated (164 F. 2d, at p. 135):

> "It is evident that the Tax Court's error in the instant case flows from its misconception (1) as to the *compelling necessity to establish existence of legal 'consideration'* at the time of the creation of the transfers and (2) from its interpretation of the legal content of the term 'consideration'." (Italics supplied).

As stated in the *Lueders* case (164 F. 2d, at p. 135):

> "It is too well-settled to require citation that generally for an act to constitute consideration it is essential that it or the promise to do it be simultaneous with the execution of the contract. Also, that it is the presence of legal consideration which makes a transfer of property a sale and the absence of consideration which makes a transfer a gift."

Thus, when the transfers are made at different times, an agreement must be shown to have existed in order to find a consideration.

In *McLean v. Commissioner*, 41 B.T.A. 1266 (1940), (affirmed on this point in *Commissioner v. McLean, supra*), the Board of Tax Appeals, applying the same principles in a gift tax case, held that identical trusts executed by a husband and wife simultaneously for the benefit of each other were "absolute gifts" and declared (41 B.T.A., at p. 1267):

> "* * * The fact that the trusts were created at the same time and contained reciprocal provisions does not prove

that one was created in consideration of the other, and the fact that the transfers were in equal amounts and made at the same time does not show that one was made in consideration of the other."

The Fifth Circuit, affirming, stated (127 F. 2d, at p. 943):

"* * * Neither in the transfers nor in the stipulation is there any statement that the transfer by petitioner was in consideration of the transfer by his wife or vice versa. Nor is there any evidence from any source that the transfers in trust were other than *donative in intent* and in effect. Taxpayer may not by merely pointing to the fact that the trusts were created at the same time; were in equal amounts; and contained reciprocal provisions, claim a discharge of the burden resting on him to show that the transfers were *made in consideration* of each other. * * *." (Italics supplied).

Of course, in the *McLean* case it was the taxpayer who contended that the trusts were created in consideration of each other, whereas in the present case it is the Government which contends for that position. But no matter which side is on the initiative, the *McLean* case demonstrates that whether transfers were made in consideration of each other *does not depend* upon the facts that the trusts were created at the same time, were in *equal amounts*, and contained *identical reciprocal provisions*. Those are not the pertinent facts with respect to *whether the transfers were made in consideration of each other*. Other facts, pertaining to the motivating causes of the transfer, are determinative as to whether the transfers in trust were other than donative in intent and in effect.

In *Estate of Lindsay v. Commissioner, supra*, a husband had signed a trust instrument, with a life estate to his wife,

between the 4th and 19th of December, 1934, but dated it December 28, 1934, and it was delivered to and accepted by the trustee on the latter date; his wife signed a similar trust instrument with a life estate to the hubsand on December 27, 1934, and it was also delivered to and accepted by the trustee on December 28, 1934. Both trusts consisted of corporate stocks, and they were in substantially equal amounts. The Tax Court, nevertheless, held they were not executed in consideration for each other based on its finding that: "We are satisfied, on the record, that there was neither *agreement* nor tacit *understanding* between the two grantors that the trusts should be created" (2 T.C., at p. 178); and that "The clear inference from the testimony * * * is that there was no concert of action or *prearranged agreement* between the parties" (2 T.C., at p. 179).

The Tax Court appropriately declared in *Estate of Ruxton v. Commissioner*, supra (20 T.C., at p. 494):

> "The very nature of the issue involved herein is such as to raise doubts in reaching an ultimate conclusion. However, in addressing ourselves to the question we are not unmindful that the doctrine of 'reciprocal' or 'crossed' trusts which respondent seeks to apply is not a statutory provision made operative by the specific terms of a trust instrument of the decedent, but instead is a concept of the courts. That concept is based on reason and analysis where the facts and circumstances of a particular case warrant going outside the formal terms of a trust instrument and looking to the *reality* of the situation, namely, that a person other than the nominal grantor is the *actual transferor* of property with retained economic interests in or control of the property, thus obtaining the same resultant tax con-

sequences as if such person had done directly what he tried to do by indirection. In our opinion, *that doctrine should be applied only when clearly warranted* by *the particular facts of a case* considered in the light of the decided cases." (Italics supplied).

The Tax Court also pointed out (20 T.C., at p. 495):

> "We think the motives of the parties certainly have a bearing on their *intentions with respect to* unity of purpose, interdependence, and *consideration or the lack thereof.*" (Italics supplied).

> "In the instant case, the uncrossing of the trusts and the transportation of the decedent and her husband as the grantor of the other's trusts would place each of them in a position entirely untenable with the giving of a *quid pro quo* to induce the action of the other and also untenable with the materially different expressed desire or purpose of each as evidenced by their respective trusts."

B. The consideration test as set forth in the Lehman case has been expressly recognized, accepted and approved as the appropriate judicial standard.

As pointed out by the petitioner (Pet. Br., pp. 8, 13-14, 22-25, 28, 33, 35), Congress, in the Technical Changes Act of 1949, considered it necessary to provide relief against the harshness and inequity of retroactive applications of the Lehman rule, and in the committee reports expressly stated the Congressional understanding of that rule to be as follows (S. Rep. No. 831, 81st Cong., 1st Sess., pp. 5-6, as quoted in Pet. Br., p. 23):

> "However, in 1940 in *Lehman v. Commissioner*, 109 F. 2d 99, the Circuit Court of Appeals for the Second

> Circuit held that *where trusts are found to have been created each in consideration of the other*, the nominal grantors are to be interchanged for tax purposes." (Italics supplied).

See, also, H.R. Rep. No. 920, 81st Cong., 1st Sess., pp. 5-6.

The committee reports plainly show that Congress addressed itself exclusively to the consideration test as enunciated in the *Lehman* case, for the committee reports do not mention any other case or any other test.

Thus, if the relief provision can be construed as equivalent to Congressional enactment of the *Lehman* decision, as petitioner asserts, it is clear that Congress expressly recognized, accepted and approved the test of whether "the trusts are found to have been created each in consideration of the other", as conceived in the *Lehman* case, as the correct and appropriate standard for determination of whether "the nominal grantors are to be interchanged for tax purposes." It follows, under this test, that there is no foundation for interchanging trusts which are found *not* to have been in fact created "each in consideration of the other," but as gratuitous gifts inspired by the donative instincts of each transferor.

C. The Internal Revenue Service has recognized and applied the consideration test as the proper and essential standard for identifying the transferor as settlor of a trust.

The Internal Revenue Service has long recognized the consideration test, as announced in the *Lehman* case and followed in all of the other cases cited above, as the deter-

minative test of whether one grantor should be treated as the grantor of a trust for his benefit created by another. For example, in Rev, Rul. 57-422, 1957-2 C.B. 617, the Revenue Service states, with respect to simultaneous transfers by a husband and wife of X Company stock in trust to each other for life with remainder to their children:

> "H is presumed to have granted W a life estate in the trust created by him *in consideration of* receiving a life estate in the trust created by her. *Therefore*, each decedent may be regarded * * * as the grantor of the trust in which the decedent was the life beneficiary and as having retained a life interest in the right to the income from the property transferred by the decedent in trust." (Italics supplied).

Besides applying the consideration test in countless administrative dispositions of estate tax cases, the Government has successfully argued in cases such as *Estate of Guenzel, supra*, and *McLean v. Commissioner, supra*, that a husband may not be treated as having made a transfer to an identical trust which his wife simultaneously created in the absence of proof that the trusts were created in consideration of each other.

D. The Court of Claims in the decision below correctly applied the principles established by judicial doctrine, Congressional approval and administrative practice.

As the above analysis reveals, all of the judicial decisions in cases involving the issue presented in this case have uniformly and harmoniously applied the rule, as originally formulated in the *Lehman* case almost three decades ago,

as recognized and approved by Congress, and as administratively applied.

The essential criterion applied in all of the cases has been simply a question of fact whether one trust was made in consideration of the other. The "consideration" concept embraced in this principle is not, as petitioner asserts, a narrow technical concept confined to the law of trusts and contracts. It is, instead, a commonly understood term which pervades all areas of law, especially tax law, and most particularly estate tax law. The term "consideration", in fact, appears in Section 811(c)(1), the very statute here being applied.

The term "consideration" has been used in the "reciprocal trust doctrine" cases, and was used by the Court of Claims in the decision below, in its commonly understood sense. As formulated in the *Lehman* case, it embodies the question whether the decedent's transfer of his property "caused" the recipient to make a transfer of property for the decedent's benefit, or as otherwise expressed in that case, whether the decedent by paying a *quid pro quo* has caused another to make a transfer of property for his benefit (109 F. 2d, at p. 100), or, as restated in the *Hanauer* case, "whether the decedent's property, by its transfer in trust, had served as a *quid pro quo* effective to bring about his brother's transfer" (149 F. 2d, at p. 858).

This question cannot be answered merely by looking at the forms of the trust instruments to see if they are

similar in wording, or merely by reference to the times of the transfers or who prepared the papers or arranged the necessary formalities, although these and other matters of form and superficial appearance should certainly be taken into consideration as circumstantial factors from which the purpose, reason, motivation or "cause" of the transfer of property may be inferred. But even where those circumstantial factors, or some of them, are present, they should not preclude consideration of any other available evidence, in balanced perspective, that may serve to illuminate the real causes of the transfer.

The Court of Claims, in deciding this case, specifically applied the Congressionally-approved *Lehman* rule in the same terms as it was originally expressed by the Second Circuit Court of Appeals, and sought to determine the question of fact raised by the *Lehman* doctrine: whether Janet was "induced or caused" to transfer her property to the Janet Grace trust by the decedent's previous transfer of his property to the Joseph Grace trust (Op. 4-5, R. 60); and whether the decedent by his transfer in trust was "furnishing consideration for", or "paying for". Janet's transfer in trust (Op. 4, R. 60). The Court of Claims took into account that, "unless rebutted by clear evidence", consideration may be "inferred from the fact that the properties included in the two trusts are of approximately the same amount, that the trusts are created at or about the same time, and that each grantor gives the other a life estate in income" (Op. 13, R. 70); taking "the view of those cases

which impose the burden on the taxpayer to rebut any inference arising under the circumstances", the Court concluded: "* * * we think the burden has been met." (R. 74)

Based on all of the evidence, which was voluminous, the Court of Claims found that neither settlor's transfer of property in trust was in consideration of the other settlor's transfer of property in trust (Finding 30, R. 109). This fact finding, which is not disputed by the petitioner, required a decision for respondents according to the *Lehman* doctrine.

II. ANSWER TO PETITIONER'S BRIEF.

A. The trusts involved in this case are not in fact similar to the hypothetical "prototype" reciprocal trusts to which Petitioner's argument is addressed.

Petitioner's argument is addressed primarily to an inflammatory condemnation of "prototype" reciprocal trusts in prejudicial terms (*e.g.*, device, scheme, formalisms ingeniously devised to escape tax, etc.) and the reasons why such prototypes should be taxed reciprocally.

Since the trusts actually involved in this case do not resemble the pattern of "reciprocal" trusts, petitioner's counsel naturally prefers to avoid discussion of the facts involved in *this* case and concentrate instead on hypothetical prototype trusts that should be taxed reciprocally.

The essence of petitioner's argument is that, because some other taxpayers (usually spouses) have created "prototype" reciprocal trusts in consideration of each other as a device to

avoid estate taxes, and because such prototypes have properly been "uncrossed" by application of the consideration test under the *Lehman* doctrine, the decedent in this case should be treated *as if* a "prototype" reciprocal trust scheme cleverly devised for evasion or avoidance of estate taxes is involved.

The defect in this syllogism is that the major premise is false. Petitioner's assertion that the trusts involved in this case are "prototype" reciprocal trusts is proved only by the circumstance that PETITIONER'S COUNSEL SAYS SO. No logical explanation is furnished as to how this conclusion is arrived at.

When the actual facts of this case are considered in balanced perspective, the two trusts here involved disclose no pattern similar to prototype reciprocal trusts. In fact, the Joseph Grace trust and the Janet Grace trust were by nature so non-reciprocal in effect and in their real and practical objectives and consequences that they appear to be anti-types rather than prototypes of "reciprocal" trusts.

The essential pattern of "prototype" reciprocal trusts reveals two trusts having identical subject matter. All of the cases involving trusts alleged to be reciprocal (including the cases holding such trusts not taxable reciprocally) have involved two trusts having identical corpus, or so nearly identical that the real and practical effect is the same in substance as if each settlor had retained an interest in the property which he himself transferred in trust. By contrast,

the subject matter of the Janet Grace trust, which consisted principally of the family homestead, was entirely different and opposite in nature and economic significance as compared with the subject matter of the Joseph Grace trust, comprised of speculative investment assets. The very objective of the prototype reciprocal trust device is that each grantor seeks to retain the equivalent of an interest in the property he purports to give away by exchanging it for an interest in property that is for all practical purposes identical. By contrast, the homestead property of the Janet Grace trust was so distinctly opposite in functional nature from the properties which the decedent transferred to the Joseph Grace trust that the "prototype" objective could not be achieved, for the Janet Grace trust did not give the decedent an interest in properties similar to the investment assets he transferred to the Joseph Grace trust.

More importantly, the real and practical economic objectives and effects of the Joseph Grace trust were entirely different from those of the Janet Grace trust. The creation of the Janet Grace trust was for all practical purposes without any economic consequences. Both Janet and the decedent had occupied Tullaroan as their home for 20 years before Janet transferred the legal title to the Janet Grace trust, and b th undoubtedly had every expectation of continuing to do so for the rest of their lives. The creation of the Janet Grace trust did not result in any change in the possession, enjoyment or use of the homestead by either the decedent or his wife. The net effect was that she would

continue to possess and enjoy the homestead at his sufference instead of him at hers, which was surely of little practical or economic consequences to either of them. The creation of the Janet Grace trust, obviously, did not have the substance or economic effect of permitting the decedent to "retain" for his life the right to the income from his commercial investments which he transferred to the Joseph Grace trust. By creating the Joseph Grace trust, on the other hand, the decedent parted with the ownership of substantial real estate investments which passed outright to his children some 13 years before he died.

While Janet Grace, in creating the Janet Grace trust, doubtless retained possession and enjoyment of the Tullaroan property and the stock committed to payment of taxes upon it, and intended to retain the possession of that property for the rest of her life, this retention of possession was not derived from the decedent's transfer of his properties to the Joseph Grace trust. The fact that the Joseph Grace trust was created within the same month did not have the effect of permitting Janet to retain possession of the Tullaroan property which she transferred to the Janet Grace trust. She retained possession and enjoyment of Tullaroan without regard to, and without any particular relationship to, the Joseph Grace trust. She would have retained the possession and enjoyment of Tullaroan even if the decedent had not created the Joseph Grace trust, and the decedent's transfer of investment assets to the Joseph Grace trust did not add or contribute anything to Janet's retention of the possession and enjoyment of Tullaroan.

There is, therefore, in the objective economic results of the two trusts involved in this case, an absence of the pattern of reciprocity usually attributed to prototype reciprocal trusts. Moreover, there is simply no way that these particular trusts could conceivably have accomplished the hoped-for objectives of prototype reciprocal trusts as described in petitioner's brief.

There is lacking, too, in the pattern revealed by the Joseph Grace trust and the Janet Grace trust, the reciprocation of taxable incidents that is the essential characteristic of the reciprocal trust device, described in petitioner's brief as follows (Pet. Br., p. 13):

> "Under this device two or more people would each establish a trust, giving one of the others a lifetime interest in or some power over the corpus. Such an interest or power, if retained in favor of the settlor of the trust, would have required inclusion of the corpus in the settlor's estate upon his death. The hope was to avoid the thrust of the predecessors of Sections 2036-2038, which then, as now, expressly spoke only in terms of interests or powers retained in the settlor."

The whole object of such a reciprocal device was for each settler to *rid* himself of all taxable powers over the corpus by exchanging taxable powers with the other settlor. Yet the decedent and his wife, instead of *exchanging* taxable powers, each *retained* for himself and herself, respectively, by the express terms of their trust instruments, a sufficient power over the corpus of his or her own trust to require inclusion of the corpus of the trust created by each in his or her taxable gross estate. Under clause *First* of each trust instru-

ment, each settlor, as one of three trustees of the trust he or she created, expressly retained the power to change the enjoyment of the corpus through the exercise of a power to alter, amend or revoke by distributing to the life beneficiary "any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time in their sole discretion deem advisable." (Findings 11(a) and 12(a), R. 93, 98-99). Such a power retained by the settlor required inclusion of the corpus in the settlor's estate upon his or her death while holding the power, under Section 811(d) (2) of the 1939 Code and the identical provisions of Section 302(d) of the Revenue Act of 1926 as in effect at the time of creation of these trusts. *Lober v. United States*, 346 U.S. 335 (1953), affirming Court of Claims decision, 124 Ct. Cl. 44, 108 F. Supp. 731 (1952); *Commissioner v. Holmes*, 326 U.S. 480 (1946); *Commissioner v. Estate of Newbold*, 158 F. 2d 694 (2d Cir. 1946); *Hurd, Exrs. v. Commissioner*, 160 F. 2d 610 (1st Cir. 1946); *Mellon, et al, Exrs. v. Driscoll*, 117 F. 2d 477 (3rd Cir. 1941), cert. den. 313 U.S. 579; *Welch v. Terhune*, 126 F. 2d 695 (1st Cir. 1942), cert. den. 317 U.S. 644; *Union Trust Co. v. Driscoll*, 138 F. 2d 152 (3rd Cir. 1943), cert. den. 321 U.S. 764; *Estate of Loughridge v. Commissioner*, 183 F. 2d 294 (10th Cir. 1950), cert. den. 340 U.S. 830; *Estate of Inman v. Commissioner*, 203 F. 2d 679 (2d Cir. 1953); *Estate of Mollenberg v. Commissioner*, 173 F. 2d 698 (2d Cir. 1949); *Zirjacks v. Scofield*, 197 F. 2d 688 (5th Cir. 1952); and compare *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935).

The transfers in trust by the decedent and Janet did not at the time of execution thereof diminish the taxable gross estate of either of them. These trusts could not have accomplished the estate-tax-avoidance purpose of the reciprocal trust device as postulated by the petitioner, and neither of the trusts had that effect.

Being by their very nature and effects (whether viewed from the standpoint of practical economic effects or from the standpoint of estate tax attributes) non-reciprocal and non-reciprocating, these trusts simply do not fit the pattern of the hypothetical prototype against which petitioner's brief inveighs so invidiously.

B. Alternative tests of liability advocated by Petitioner are inadequate and unworkable.

Paradoxically, while petitioner's brief speaks in grand platitudes of the virtue of substance and reality over mere form, the variously stated tests or rules advocated by the petitioner as a substitute for the consideration test, as enunciated in the *Lehman* doctrine, are all aimed at exalting mere formalisms. Each of these proposed substitute tests is aimed at making the liability for estate tax dependent solely upon a restricted selection of facts related only to the form of the transaction, as determinative of the issue. Under any of the various tests proposed by petitioner, the courts would be precluded from considering any evidence with respect to the true substance and reality if the prescribed formal factors are present. Petitioner advocates,

in effect, that the Court overrule the *Lehman* principle and substitute a new doctrine making taxability depend solely upon such formalisms as the dates and provisions of trust instruments, whether they are drafted by the same lawyer, or other such matters of form, without regard to any other evidence pertaining to the question of whether the decedent is, in substance and reality, the person who "made a transfer" of the property in which he has a life estate. While making taxability dependent upon any such empirical data may have the virtue of ease of administration, it would be wholly inadequate to deal with the problem to which the *Lehman* principle is addressed.

The applicability of the "consideration" test is not dependent upon form, but searches out the substance and reality of the transactions. To reach this objective, the trial courts should be allowed to hear and consider all evidence available with respect to the true nature and substance of a transaction and the causes which motivated it, instead of being restricted to an observance of such superficial data as proximity of time, identical formal wording of instruments, or any other pure formalisms restricting the scope of the inquiry.

The consideration test as enunciated in the *Lehman* doctrine provides the one true and adequate test of whether, in any realistic sense, a decedent has "made a transfer under which he has retained" a property interest within the meaning of the statute. This principle should be adhered to as a salutary principle of tax law.

The "net effect" test advocated by Professor Lowndes (Pet. Br., 33-34) may be an adequate and proper standard for determining the extent of a taxpayer's liability, once he is determined to be liable, but provides no clue to whether or not the decedent has made a transfer of the character subject to tax. It can be applied only after reaching the conclusion that the decedent has made a transfer of the character subject to tax.

Accordingly, respondents urge the Court to reject the substitute tests and adhere to the *Lehman* principle as heretofore established.

C. Directly and indirectly, the petitioner has attacked the findings of fact below; however, those findings are sound and not "clearly erroneous".

Petitioner's brief attempts to side-step, minimize, or obliquely challenge the findings of the Court of Claims. This has been done by way of attacks on consideration, on the bearing of motivation and intent, and by way of a slippery "single transaction" argument. In the final portion of its brief the Government, as an alternative argument, seeks to overturn the findings directly.

We note first that the attempt to secure a reversal by charging error in deciding questions of fact appears not to be comprehended within the Petition for a Writ of Certiorari which this Court granted. The "Question Presented" (Pet. Br., p. 2) purported to state a question of law. The "Reasons" for grant offered in the petition were an alleged con-

flict between some decisions of the Courts of Appeals and the Court of Claims (Pet., pp. 7-14), alleged error by way of "a mistaken view of the statute" (Pet., pp. 14-17), application of the wrong legal standards by the court below (Pet., pp. 17-18), and the importance of the question to estate tax administration (Pet., 18-19). The respondents find no assertion in that petition that the findings of fact of the Court of Claims were "clearly erroneous". It is, however, the customary practice of the Court to consider only questions "urged in the petition for certiorari and incidental to their determination." *Rorick v. Devon Syndicate, Ltd.*, 307 U.S. 299 (1939). See, also, *Ryan v. United States*, 379 U.S. 61 (1964); *Trailmobile Co. v. Whirls*, 331 U.S. 40 (1947).

In the event, the grounds on which the petitioner would have this Court overrule the Court of Claims on fact-finding are a melange of odds and ends, and a thing of bits and tatters. The Government argues that Janet Grace was a non-entity, whose ideas were of "no importance" (Pet. Br., pp. 37-8). The Government argues that the taxpayer had the burden of proof (Pet. Br., p. 38) — which no one has ever disputed. The Government argues that there was a "single transaction" and no consideration was necessary (Pet. Br., p. 39). Finally, the Government urges that Joseph Grace was clearly an estate tax avoider, because Mr. Ross urged Mr. Iglehart to create reciprocal trusts and Iglehart was a friend of Joseph Grace (Pet. Br., pp. 39-40). To these contentions the Government adds its own argumentative, speculative inferences, e.g., "decedent may have been

less cautious than Ross" (Pet. Br., p. 41). These are makeweight arguments, all of which were presented to and thoroughly considered by the court below.

There is no doubt that the "question of whether the doctrine of the *Lehman* case can be applied—whether the trusts are crossed or reciprocal trusts—is one of 'fact.'" *Estate of Moreno v. Commissioner, supra.* Obviously, upon different evidence one court may reach a different conclusion than another without either court being in error. See *Estate of Hanauer v. Commissioner, supra.*

As an initial matter, the question whether a transaction or series of transactions is to be viewed as an integral whole is an issue for resolution by the fact finders whose decision will be reversed only if clearly erroneous. *Tennessee, Alabama & G. Ry. Co. v. Commissioner*, 187 F. 2d 826 (6th Cir.). "It is for the trial court upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs." *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 456 (1950).

The scope and nature of review of a factual determination has been the subject of definitive analysis by this Court in the tax case of *Commissioner v. Duberstein*, 363 U.S. 278 (1960). The ultimate factual issue there—whether gifts were made—is analogous to the ultimate issue here. The Court's analysis of the weight to be given to well-grounded conclusions of a trial tribunal with respect to such matters is apropos (363 U.S., at pp. 289-90):

> "Decisions of the issue presented in these cases must be based ultimately on the application of the fact-finding

tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of abscribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact.

* * *

"Doubtless diversity of result will tend to be lessened somewhat since federal income tax decisions, even those in tribunals of first instance turning on issues of fact tend to be reported, and since there may be a natural tendency of professional triers of fact to follow one another's determinations, even as to factual matters. But the question here remains basically one of fact, for determination on a case-by-case basis."

In conclusion the Court noted that a consequence of its view "is that appellate review of determinations in this field must be quite restricted" (393 U.S., at p. 290).

III. THE WRIT OF CERTIORARI WAS IMPROVIDENTLY GRANTED; THIS CASE SHOULD BE DISMISSED FOR THAT REASON.

As we have demonstrated above (see pp. 27-46, *supra*), the petitioner's first asserted reason for granting the writ of certiorari — that cases in several circuits conflict with the decision of the Court of Claims in this case — simply does not withstand analysis. All of these cases on which the petitioner relies require consideration as a condition to application of the reciprocal trust doctrine. While some cases em-

phasize objective evidence and others the intent of the settlors, the distinction between such cases is not due to any significant divergence in the courts' views of applicable legal principles but rather to their analysis of the particular evidentiary facts that were before them. Not a single court that has decided a "reciprocal trust" case has agreed with the petitioner's argument that the decedent's motives are immaterial for purposes of determining whether, in fact, the trusts are reciprocal.

Nor does the decision below raise an important question of law which deserves this Court's special scrutiny. The petitioner has never asserted that the decision of the Court of Claims creates serious administrative problems for him in the disposition of pending cases. He merely states that he expects future attempts to minimize taxes "through resort to reciprocal trusts" (Pet. Br., p. 19). Such attempts are improbable, we may note, in view of the existing risks. In any event, possible future problems are not the kind of pressing questions which the writ of certiorari was designed to bring here. See, *e.g.*, *Brown v. Allen*, 344 U.S. 443, 491 (1953). Certainly this Court does not sit to resolve the petitioner's anticipatory administrative problems by finding different facts that did a court below.

After reviewing the petitioner's brief, it should be clear to the Court that in reality the issue here involved is essentialy factual in nature, and that the only real complaint of the Government is that it is dissatisfied with the findings of fact of the Court of Claims and essentially asks this Court to reach a different factual conclusion without having had

the opportunity to hear the evidence. Since this writ requires the Court essentially to reconsider facts found by a trial tribunal upon a full record instead of carrying out its function of determining great principles of law of national importance, the writ was improvidently granted and should be dismissed.

CONCLUSION

For the foregoing reasons the writ of certiorari should be dismissed as improvidently granted, or, alternatively, the decision of the Court of Claims should be affirmed.

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No. 574

In the

Supreme Court of the United States

OCTOBER TERM, 1968

UNITED STATES,
Petitioner,

v.

ESTATE OF JOSEPH P. GRACE, DECEASED, et al.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Claims

PETITION FOR REHEARING

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PETITION FOR REHEARING

Respondents respectfully petition the Court for a rehearing of the above-styled case on the following grounds:

GROUNDS FOR REHEARING

I. Section 811, Internal Revenue Code of 1939, as previously applied by this court, requires recognition of

the decedent's wife, Janet Grace, Rather than the decedent as the transferor or grantor of the trust created by her, in whose taxable gross estate her trust should be included.

The majority opinion rendered June 2, 1969, upholds the Commissioner of Internal Revenue in taxing to the decedent's estate property transferred in trust by his wife, Janet Grace, in reliance upon Section 811 (c) (1) (B) of the Internal Revenue Code of 1939. We respectfully call to the attention of the Court that this perverse application of Section 811 is directly contrary to long established principles of estate taxation as previously declared by this Court in *Lober v. United States*, 346 U.S. 335 (1953); *Commissioner v. Holmes*, 326 U.S. 480 (1946); *Commissioner v. Estate of Church*, 335 U.S. 632 (1949); *Estate of Spiegel v. Commissioner*, 335 U.S. 701 (1949) and *Helvering v. Hallock*, 309 U.S. 106 (1940).

Subdivisions (c) and (d) of Section 811 are directly parallel. Each subdivision requires inclusion in the gross estate of a decedent of property * * * "to the extent of any interest therein of which *the decedent* has at any time *made a transfer*" of the kind specified.

This Court's prior decisions above cited, as well as others in harmony therewith, have unequivocally held that, as applied to the facts in this case the properties transferred in trust by the decedent's wife, Janet Grace, must be taxed to the estate of Janet Grace (instead of to her husband's estate) as the statutory "decedent" who "made a transfer" of this property under which *she* retained a power to alter, amend or revoke that trust which she created, by the direct

application of the inexorable and ubiquitous statutory language of Section 811(d)(2).

In creating the Janet Grace trust, the decedent's wife (1) named *herself* as one of the three trustees, and (2) reserved the power to herself, in conjunction with either one of the other two trustees, to alter the trust by paying to the primary life beneficiary "any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time to time deem advisable." [Finding 12(a) App. 98-99]

In *Commissioner v. Holmes, supra* this Court squarely held that such a power of termination results in an incomplete transfer with the consequence that the transferor (in this case, Janet Grace) is to be treated for estate tax purposes as owner of the transferred property at the time of her death because of her retained powers over it. The Court there declared, with reference to a power retained by the settlor virtually identical to the power retained by Janet Grace over the trust in question (326 U.S. at 487, 66 S. Ct. at 260):

> "A donor who keeps so strong a hold over the actual and immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which §811(d)(2) requires in order to avoid the tax."

The Court reiterated and amplified that holding in *Lober v. U. S., supra,* where this Court, speaking through Mr. Justice Black, stated (346 U.S. at 336):

> "In *Commissioner v. Holmes* * * * we held that power to terminate was the equivalent of power to 'alter,

amend or revoke' it, and we approved taxation of the Holmes estate on that basis. * * *

Rejecting an asserted distinction between *Holmes* and *Lober* to the effect that in the former case the interests of ultimate beneficiaries were contingent and could be cut off by accelerated distribution, whereas in the latter case the beneficiaries' interests were vested and distribution could only be accelerated to the same beneficiaries who would ultimately become entitled to the trust properties, the Court further declared in the *Lober* case (346 U.S. at 337):

> "* * * This father could have given property to his children without reserving in himself any power to change the terms as to the date his gift would be wholly effective, but he did not. * * *"

Likewise, Janet Grace could have given her homestead to her husband for life with remainder to her children, without reserving to herself any power to change the terms as to the date her gift would be wholly effective. Having expressly retained such a power to alter the trust, she obviously did not divest herself "of that degree of control which §811 (d) (2) requires in order to avoid the tax", as this Court held in the *Holmes* and *Lober* cases. See, also, *Michigan Trust Company v. Kavanagh*, 284 F. 2d 502 (6th Cir., 1960), where the Court of Appeals explicates (284 F. 2d at 505):

> "And so, Holmes and Lober clearly indicate that a power to invade corpus and distribute to the beneficiaries is a power to alter, amend or revoke, under the statute, and this includes a power to terminate the trusts, altogether."

To the same effect, see *DuCharme's Estate v. Commissioner*, 164 F. 2d 659 (6th Cir., 1947); *Hurd v. Commissioner*,

160 F. 2d 610 (1st Cir., 1947); *First National Bank of Portland v. United States*, 250 F. Supp. 213 (S.D. Me. 1966).

As §811(d)(2) expressly refers to powers exercisable "either by the decedent alone or in conjunction with any person", there can be no question that the reservation of this power to a majority of three trustees, of whom Janet Grace was one, was a power exercisable by her in conjunction with another person. See *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935).

Besides Janet Grace's status as taxable transferor deemed to have retained ownership of this property under Section 811(d)(2), the direct and obvious application of Section 811(c)(1)(B), which the majority opinion deems applicable, requires the treatment of Janet Grace as continued owner until her death of the properties which she transferred to the Janet Grace trust.

See finding 12(c) (App. 30-31):

> "At the time of the creation of the Janet Grace trust, there was no indication that * * * Janet Grace * * * ever expect to leave Tullaroan during their lives; and in fact both continued to live there until they died. There was no change whatever in the use and enjoyment of the homestead by * * * Janet Grace * * * as a result of the transfer of the legal title from Janet Grace to the trustees of the Janet Grace trust."

Moreover, Joseph Grace exercised a limited power of appointment under the Janet Grace trust instrument almost immediately after creation of that trust so as to give Janet Grace a successive life estate in the trust property should

he predecease her. See Deed of Appointment dated January 27, 1932, *Commissioner's Exhibit 36.*

In the *Spiegel* case, this Court speaking through Mr. Justice Black declared, in unequivocal terms ringing with clarity (335 U.S. at 705):

> "* * * In the Church Case we stated that a trust transaction cannot be held to alienate all of a settlor's 'possession or enjoyment' under § 811(c) unless it effects 'a bona fide transfer in which the settlor, absolutely, unequivocally, irrevocably, and without possible reservations, parts with all of his title and all of his possession and all of his enjoyment of the transferred property. After such a transfer has been made, the settlor must be left with no present legal title in the property, and no right to possess or enjoy the property then or thereafter. In other words such a transfer must be immediate and out and out, and must be unaffected by whether the grantor lives or dies'. * * * He has therefore not made that 'complete' kind of trust transfer that § 811(c) commands as a prerequisite to a showing that he has certainly and irrevocably parted with his 'possession and enjoyment'.

See, also, *Helvering v. Hallock*, 309 U.S. 106, 60 S. Ct. 444, 125 ALR 1368; *Smith v. Shaughnessy*, 318 U.S. 176, 63 S. Ct. 545.

In the *Church* case, *supra*, Mr. Justice Black, speaking for the Court, explained the rationale of the *Hallock* case in the following terms (355 U.S. at 643-644):

> "* * * We declared that the statute now under consideration 'taxes not merely those interests which are deemed to pass at depth according to refined technicalities of the law of property. It also taxes inter vivos transfers that are too much akin to testamentary

> 'dispositions not to be subjected to the same excise,' p. 112, 'and inter vivos gifts resorted to, as a substitute for a will, in making dispositions of property operative at death' p. 114. * * *
>
> Moreover, the *Hallock* Case, p. 114, stands plainly for the principle that 'In determining whether a taxable transfer becomes complete only at death we look to substance, not to form * * * However we label the device if it is but a means by which the gift is rendered incomplete until the donor's death' the 'possession or enjoyment' provision applies."

Measured by these clear and inexorable standards, Janet Grace, when she transferred the homestead property which she had owned for over 20 years along with 40 shares of stock producing enough income to pay the taxes on it, to herself as trustee with reserved powers and without any change in her continued possession and enjoyment of the property, failed to make a sufficiently completed transfer to be cognizable for federal estate tax purposes. Instead because of her retained possession and enjoyment (§ 811(c) (1) (B)) and her retained power to alter the trust, which she kept until her death (§ 811(d) (2)), she made a postponed transfer "much too akin to testamentary dispositions" not to be subjected to treatment as "a substitute for a will, in making dispositions of property operative at [her] death."

This Court's decisions in the *Holmes*, *Lober*, *Spiegel*, *Church*, *Hallock* and similar cases have long since become great landmarks of federal estate tax law, which have breathed life and meaning into Section 811 (c) and (d), 1939 Internal Revenue Code. The fundamental concepts

therein announced, and now universally recognized as touchstones of estate taxation, should not now be silently overruled by the majority opinion in the present case. Notwithstanding that it was the decedent's wife, Janet Grace, who made the transfer of her properties to the trust she created under which she retained not only the possession and enjoyment of her property for life but also a power to alter the disposition of it, the majority opinion inexplicably fails to recognize Janet Grace as the transferor in whose taxable estate this property must be included for estate tax purposes in accordance with the principles long adhered to by this Court.

Once Janet Grace is recognized as the statutory transferor who "made a transfer" of this property "under which she retained" the taxable incidents of ownership of this property, it becomes obvious that her husband, the decedent whose estate is presently before the Court, is *not* the person who "made a transfer" of that property "under which the transferor retained" the life estate that was given to him by his wife.

If Janet Grace had devised and bequeathed a life estate in the homestead and 40 shares of stock to her husband in her will, no one would contend that the property would be taxable to the estate of her husband, the life tenant, upon his death. Yet, under the principles of this Court's previous decisions, she should be treated as having made a testamentary disposition, resorted to as a substitute for a will. Should not the estate tax consequences be the same as if she had devised this property by will?

While we subscribe completely to the statement of the majority opinion that "the taxability of a trust corpus * * * does not hinge on a settlor's motives, but depends on the nature and operative effect of the trust transfer", we respectfully submit that the Court failed to recognize that the true "nature and operative effect" of the Janet Grace trust was, in accordance with the principles established by this Court's previous federal estate tax decisions, an incomplete and ineffective transfer *by Janet Grace*, taxable as a testamentary devise by her, operative at *her* death and fully taxable as part of *her* gross estate. The decedent whose taxable estate is here involved was merely a recipient donee life tenant of the property transferred in trust by his wife whose estate was taxable on her disposition of it effective at her death.

We respectfully submit that the majority opinion errs in approaching the issue presented by this case as if the question were whether the trust which the Government seeks to tax to the decedent's estate is taxable at all, or should be permitted to escape estate taxation entirely. See footnote 8 to the opinion, which indicates the Court's understanding that the creation of this trust was part of "an arrangement under which he and his wife retained present enjoyment of the property and under which the property would pass to their children without imposition of either estate or gift taxes." This statement, we submit, entirely misconceives the facts and law of the case.

Respondents do not contend, as the opinion seems to assume, that the trusts involved were without estate tax

consequences, or that either trust was non-taxable. Instead, the proper question is to *whose* estate the Janet Grace trust is properly taxable under Section 811 of the 1939 Internal Revenue Code. Under the plain and inexorable language of Section 811 (c) and (d), as well as the previous decisions of this Court giving full scope and meaning to these statutory provisions, the Janet Grace trust was fully taxable as a part of *her* taxable estate, and the trust created by Joseph Grace fifteen days earlier likewise remained a part of his taxable estate so long as he retained the taxable power, as one of its trustees, to alter the trust by distributing the principal to his wife. See the *Lober* and *Holmes* cases, *supra*. Under these established principles, each trust was wholly ineffective to avoid any estate taxes, and each trust should be held includable only in the estate of the transferor of properties who "made a transfer under which he retained" the taxable incidents as prescribed by statute.[1]

II. The Opinion of June 2, 1969, if permitted to stand, will obstruct and obfuscate the orderly administration of the Estate Tax Laws and result in double taxation.

The majority opinion, by treating a person other than the person who owned the property, and from whom title passed in trust, as the party to be taxed as transferor of the property, instead of the actual transferor, merely be-

[1] The Joseph Grace trust, to which the decedent transferred various commercial investment real estate interests on December 15, 1931, terminated in 1937, some 13 years before he died, at which time he lost all power or interest or control which he originally retained with respect to those properties, and even the petitioner concedes that trust is not properly to be included in his estate, because he irrevocably parted with those properties during his life.

cause the trust to which the transfer is made is "inter-related" in some undefined way to another trust created by another party, renders the statute of such dubious and transitory meaning as to result in vast chaos and uncertainty as to whom the statute does or does not apply.

No concept of maximizing the revenue, nor even a prejudicial bias in favor of the Government winning all tax cases, would justify the loose and inarticulate application to the estate tax in this case. For the Government, no less than its taxpaying citizens, benefits from consistency in the application of definitive principles of taxation which can be administered with certainty of application. And consistent application of a loosely formulated "inter-related" trust test for switching the identity of the transferors, while it may be capable of such discretionary inconsistency in administration as to amount to arbitrary administrative authority to levy taxes wherever the maximum revenue will result, will not necessarily always have that result.

For example, a husband and wife or other relatives who each make gifts in trust near in time may be held not liable for gift taxes as donor, on the ground that the other spouse made the transfer, instead of the spouse who actually transferred the property. See, for example, *McLean v. Commissioner*, 127 F. 2d 942 (5th Cir., 1942), where the taxpayers, husband and wife, created identical trusts for the benefit of each other at the same time and contended these trusts were not taxable because they were created as consideration for each other, and it was the Government which denied that the trusts were reciprocal in the absence of actual

proof that one was executed as consideration for the other. Since the gift tax is complementary to the estate tax and "*in pari materia*" with it, the same principle should apply consistently, and there would be no logical reason to subject one spouse to gift tax as if he were the transferor and tax the opposite spouse's estate as if she were the transferor.

Likewise, even in the estate tax field, it is not necessarily to the Government's advantage to switch the transferors for tax purposes. See, for example, *Commissioner v. Estate of Guenzel*, 258 F. 2d 248 (8th Cir. 1958) where a husband's estate contended that a trust created by him should not be included in his estate because, by application of the reciprocal trust doctrine, his wife was to be treated for tax purposes as the settlor who made a transfer to his trust. In that case, it was the Government which insisted that the reciprocal trust doctrine was inapplicable because of the absence of strict proof that the two trusts were created in consideration of each other, notwithstanding that the wife's estate had previously been taxed on the husband's trust on the ground that the trusts were "reciprocal". In the *Guenzel* case the Eighth Circuit decided in favor of the Government, on the theory which respondents urge here (258 F. 2d at 254):

> "The Lehman doctrine has generally been used to reach trusts on the principle of looking to the substance rather than the form when the trusts, on the basis of their language, are apparently free from tax. * * *
>
> "Since the trust created by each of the Guenzels was by its terms taxable as a transfer against the estate of the grantor of the trust, there was no need to resort

> to the Lehman doctrine to make the value of the trusts subject to estate tax. Additionally, there is considerable doubt whether the Lehman doctrine can properly be applied to the trusts here involved. * * *"

As the *Guenzel* trusts were "inter-related" to a much greater extent than the *Grace* trusts, the application of the new doctrine announced in the opinion in the present case would clearly have required that the identities of the grantors of the Guenzel trusts must be interchanged on the grounds that the trusts were "reciprocal", resulting in loss by the Government.

Perhaps a more serious evil, from the standpoint at least of the nation's taxpaying citizens, is the probable use of the new doctrine announced in the present decision to effect double taxation clearly not intended by Congress. Is it not abundantly clear that if Janet Grace's estate were before the Court in the present case, the Janet Grace trust would be included in her taxable estate under the *Lober* and *Holmes* decisions? Is it not equally clear that the result of the opinion of June 2, 1969, would require also that the trust created by Joseph Grace fifteen days earlier be included in her estate as reciprocal? Thus, the new theory would require taxation of Janet Grace as transferor of both trusts, when in reality she obviously "made a transfer" of her property to only one trust. And in many instances, when both spouses have died, the Government will have collected estate taxes on four trusts where only two were created, and perhaps gift taxes as well on the same trusts.

This is a clear case of overkill, generated by adoption of the Government's fallacious assertion that imposition of tax

on the husband's estate in this case is required to prevent avoidance of tax and close a tax "loophole", when in fact no loophole or possibility of tax avoidance ever existed, since each trust from its inception remained taxable directly as part of the estate of the respective settlor who transferred his or her property in trust retaining taxable powers over the transferred property.

The willy-nilly extension of the reciprocal trust doctrine to all "inter-related" trusts, allowing as it does discretionary multiplication of taxes at the whim of the administrative authority, is contrary to the cautiously restrictive approach of the courts in all previous cases involving application of the reciprocal trust doctrine, typified by the Tax Court's declaration in *Estate of Ruxton v. Commissioner*, 20 T.C. 487, at 494 (1953):

> "In our opinion, that doctrine should be applied only when clearly warranted by the particular facts of a case considered in the light of the decided cases."

III. The Decision of June 2, 1969 is based on erroneous fact assumptions contrary to the findings of the Trial Court and determined by the Supreme Court without hearing any evidence.

A. Relative value of transfers in trust.

At the first trial of this case in 1963, respondents (plaintiffs at the trial) presented expert valuation testimony establishing that the values of the properties transferred by Joseph P. Grace on December 15, 1931, to the Joseph Grace trust totalled $530,592.00; and that the value of the Tullaroan

property and 40 shares of Lundy's Lane Corporation transferred in trust by Janet Grace on December 30, 1931 had a total value at that time of $1,049,831.20. The Government presented no evidence to refute such values; however, the trial was adjourned without completion of the proof on such values, both sides reserving the right to present further valuation evidence, under an agreement by the parties that the primary issue whether the Janet Grace trust should be included in the decedent's estate to any extent should be submitted to the Court of Claims on the record as it then stood, so that the detailed proof as to relative values of the trusts would be completed only if the Court of Claims should decide that the Janet Grace trust was to some extent taxable to her husband's estate.

The consequence of this undetermined fact issue is that under the reciprocal trust doctrine as heretofore understood, the decedent's estate would be taxable only "to the extent" that he had "made a transfer" to his spouse's trust by furnishing consideration therefor. In other words, if the decedent transferred $530,000.00 in trust for his wife as consideration for her transfer of $1,049,000.00 in trust for his benefit, the previous cases would hold the decedent's estate taxable upon only 530/1,049ths of the value at the time of his death of the property in his wife's trust, for only to that proportionate extent is he deemed to have "made a transfer under which he retained" the benefits provided in his wife's trust. To the extent of the proportion of his wife's trust that exceeded the value of properties transferred in trust by the decedent, having given no consideration for such excess, the

decedent is deemed to have received a gift from his wife, and like any other donee-life-tenant that proportion received as a gift from his wife would not be included in his taxable estate. See *Estate of Hanauer v. Commissioner*, 149 F. 2d 857, at 859, (2nd Cir., 1945) cert. den. 326 U.S. 770, where the Court said *obiter*:

> "Doubtless in other cases in which the value of the property transferred from the decedent's estate is less than that of the reciprocal trust, that lesser value will constitute a factor limiting the portion of the reciprocal corpus which may be included in the decedent's gross estate — only in part will it constitute a *quid pro quo* for a larger trust. And if, due to this limiting factor, only a part of the value of the reciprocal corpus is includable in the gross estate, how an increment (or shrinkage) in the value of the entire reciprocal corpus account prior to the decedent's death shall be reflected in the portion thereof to be included in the gross estate is a problem which can be dealt with when it arises."

And see *Estate of Boardman v. Commissioner*, 20 T.C. 871, where the decedent transferred \$67,953.76 in trust for her spouse, who transferred \$68,226.26 to a concededly reciprocal trust for her benefit. At the decedent's death, the reciprocal trust created by her spouse was valued at \$121,490.20. The Tax Court held that the amount properly taxable to her estate was 67,953.76/68,226.26 x \$121,490.20.

We may presume that some such proportionate formula would be required under Mr. Justice Marshall's pronouncement that "* * * application of the reciprocal trust doctrine requires only that * * * the arrangement, *to the extent of mutual value*, leaves the settlors in approximately the same

economic position as they would have been in had they created trusts naming themselves as life beneficiaries." (Op. 8; see also, Op. 9) Under that formulation, the "extent of mutual value" remains to be proved. If the trier of facts finds that the decedent transferred property in trust worth only half of the value of properties transferred in trust by his wife, then only to the extent of half of the value of her trust would he be in approximately the same economic position as he would have been in had he created a trust naming himself as life beneficiary. He could not, naming himself beneficiary of his properties worth $500,000 attain the same economic effect as being named beneficiary of a $1,000,000 trust created by his wife.

Although the Court of Claims refrained from making any finding whatever with reference to the values of the properties transferred to the trusts at the time of transfer, the Court's opinion, in its recitation of facts, refers to "the smaller of the two trusts, the Janet Grace trust" (Op. 3). Presumably, the Court was led to that assumption of fact concerning relative values by the Solicitor General's assertion to that effect in argument, unsupported by any evidence or findings. This erroneous assumption of fact evidently led Mr. Justice Marshall to state in the majority opinion, that "the value of the Janet Grace trust fund must be included in the decedent's estate" (Op. 8). And, while holding that the transfers "left each party in the same objective economic position as before", only "to the extent of mutual value", and proclaiming that "economic value is the only workable criterion", the opinion concludes with

the statement that "Joseph Grace's estate remained undiminished to the extent of the value of his wife's trust and the value of his estate must accordingly be increased by the value of that trust."

This statement, if taken at face value to mean that the entire value of his wife's trust must be included in his estate, can only be based upon an assumption that Joseph Grace transferred in trust property worth at least as much as the property placed in trust by his wife; otherwise the terms "to the extent of mutual value" and "economic value is the only workable criterion" would be mere empty and meaningless phrases. This assumption of fact with reference to relative values of the properties is arrived at in the majority opinion without hearing any evidence, based on no findings of the Court below, and contrary to the only evidence now of record, which is as yet undisputed.

The Government, in its brief, did not even ask the Court to make findings of fact as to the relative values of properties. Instead, its conclusion asks that "the case should be remanded for further proceedings", with this footnote (Brief for the United States, p. 42):

> "[25]If the decision below is reversed, *the Court of Claims must decide respondents' contention* going to the *value* of the resulting addition to decedent's estate."

The Court gave the Government what it asked for and remanded the case "for further proceedings consistent with this opinion." However, such "further proceedings" would be useless if the opinion be taken at face value to require

the inclusion of "the value of the wife's trust" in its entirety in the decedent's estate.

Therefore, even if the decision is permitted to stand, it should be modified to properly state the proportion of the wife's trust that should be included in her husband's estate, leaving to the Court below the duty to ascertain the facts relevant to values of properties, based on evidence presented at the "further proceedings" to be had upon remand.

B. The Opinion of June 2, 1969 assumes a tax-avoidance motive contrary to the express findings of the court below.

The Court of Claims, after a full trial, took note of the Government's argument without proof that the trusts involved here were created for tax avoidance motives and sought to determine the possible existence of such motives by remanding the case for a further trial on the specific issue "as to whether the decedent was motivated in the setting up of the Joseph Grace and the Janet Grace trust, in December 1931, by the desire to avoid or lessen estate taxes". (See Remand Order dated March 25, 1966, App. 39.) After a full trial on that issue, the Court of Claims found as a fact that the decedent was not motivated by tax-avoidance. Yet the opinion of this Court relies heavily on a factual conclusion that "there is a high probability that such a trust arrangement was indeed created for tax-avoidance purposes" — a fact assumption arrived at without hearing any evidence relative thereto, and apparently based solely on the statement in footnote 8 (Op. 7). As

shown above, the assumptions stated in footnote 8 with respect to the estate tax effects of these trusts are contrary to the established law as declared by previous decisions of this Court applied to the trusts here involved. Sections 811(c)(1)(B) and 811(d)(2) are virtually identical in all material respects to the provisions of Section 302(c) and (d) of the Revenue Act of 1926 in effect at the time of creation of these trusts, and at that time of their creation both trusts were legally ineffective to remove any of the transferred properties from the estates of the respective transferors. The assumption, contrary to the findings of the trier of facts, of a probability that the trusts were "created for tax-avoidance purposes" is, in these circumstances, unwarranted. The existence of such a probability is a question of fact that has been determined by the trier of facts after a full hearing of all evidence concerning creation of the trusts.

C. The Opinion relies upon erroneous fact assumptions with reference to the economic consequences, arrived at without hearing any evidence and contrary to the findings of the lower court.

The majority opinion declares the new legal standard for application of the reciprocal trust doctrine, requiring that the trusts be inter-related and "that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as beneficiaries." This is essentially a question of fact as to which

respondents should be permitted to present proof. As this test has never before been recognized in the prior decisions of lower courts, and at the trial of this case the parties did not have available the guidance of this Court as to the proper test, the case was not tried with this question in mind and the trier of facts has had no opportunity to make findings relevant to the issue now presented. Neither did respondents have any occasion to present their argument to this Court with reference to the significance of the facts already found by the Court below in the application of this new standard of taxability. Consequently respondents fervently pray that the Court will permit a rehearing at which they may call the Court's attention to the facts relevant to this determination. If permitted, we shall show convincingly that the two trusts involved in this case did not in fact leave the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as beneficiaries. Specifically, we believe the evidence and findings negate the following factual conclusions upon which the decision is based:

> 1. "It is also clear that the transfers in trust left each party * * * in the same economic position as before." (Op. 8-9)
>
> 2. Indeed, it appears, as would be expected in transfers between husband and wife, that the effective position of each party *vis-a-vis* the property did not change at all. (Op. 9)

These factual conclusions are not only unsupported by any findings of the court below, but are opposite to the real and substantial economic effects of these transfers in fact.

If permitted to be heard, we shall show that the "nature and operative effect" (Op. 7) of each transfer in trust was entirely different from the other, leaving each spouse in an entirely different economic position than before, and also that the decedent occupied a position entirely untenable with a retention of any interest in the properties which he transferred in trust.

WHEREFORE, respondents request that a rehearing be granted and that upon further consideration the Court modify its decision herein, at least to the extent necessary to indicate to the court below what issues are open for its determination in the further proceedings after remand, and what standards shall be applied for resolving such issues.

Respectfully submitted,

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Attorney for Respondents.

CERTIFICATE OF COUNSEL

I hereby certify that this petition is presented in good faith and not for delay.

William S. Downard,
One Main Place,
Dallas, Texas 75250,
Attorney for Respondents.

PROOF OF SERVICE

I hereby certify that the foregoing petition has been served upon the United States by depositing a copy thereof in a United States Post Office with air mail postage prepaid, addressed to the Solicitor General, Department of Justice, Washington, D. C. 20530, this 22 day of July, 1969.

William S. Downard,
One Main Place,
Dallas, Texas 75250,
Attorney for Respondents.

SUPREME COURT OF THE UNITED STATES

No. 574.—OCTOBER TERM, 1968.

United States, Petitioner,
v.
Estate of Joseph P. Grace, Deceased, et al.

On Writ of Certiorari to the United States Court of Claims.

[June 2, 1969.]

MR. JUSTICE MARSHALL delivered the opinion of the Court.

This case involves the application of § 811 (c)(1)(B) of the Internal Revenue Code of 1939 to a so-called "reciprocal trust" situation.[1] After Joseph P. Grace's death in 1950, the Commissioner of Internal Revenue determined that the value of a trust created by his wife was includible in his gross estate. A deficiency was assessed and paid, after denial of a claim for a refund,

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[1] Section 811 (c)(1)(B) provided that—

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property . . .

. . . .

"(c) . . .

"(1) *General rule.* To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

. . . .

"(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom . . . ."

Section 811 (c)(1)(B) has been recodified as § 2036 of the Internal Revenue Code of 1954, 26 U. S. C. § 2036.

this refund suit was brought. The Court of Claims, with two judges dissenting, ruled that the value of the trust was not includible in decedent's estate under § 811 (c) (1)(B) and entered judgment for respondent. *Estate of Joseph P. Grace* v. *United States*, 183 Ct. Cl. 745, 393 F. 2d 939 (1968). We granted certiorari because of an alleged conflict between the decisions below and certain decisions in the Courts of Appeals and because of the importance of the issue presented to the administration of the federal estate tax laws. 393 U. S. 975 (1968). We reverse.

I.

Decedent was a very wealthy man at the time of his marriage to the late Janet Grace in 1908. Janet Grace had no wealth or property of her own, but between 1908 and 1931, decedent transferred to her a large amount of personal and real property, including the family's Long Island estate. Decedent retained effective control over the family's business affairs, including the property transferred to his wife. She took no interest and no part in business affairs and relied upon her husband's judgment. Whenever some formal action was required regarding property in her name, decedent would have the appropriate instrument prepared and she would execute it.

On December 15, 1931, decedent executed a trust instrument, hereinafter called the Joseph Grace trust. Named as trustees were decedent, his nephew, and a third party. The trustees were directed to pay the income of the trust to Janet Grace during her lifetime, and to pay to her any part of the principal which a majority of the trustees might deem advisable. Janet was given the power to designate, by will or deed, the manner in which the trust estate remaining at her death was to be distributed among decedent and their children.

The trust properties included securities and real estate interests.

On December 30, 1931, Janet Grace executed a trust instrument, hereinafter called the Janet Grace trust, which was virtually identical to the Joseph Grace trust. The trust properties included the family estate and corporate securities, all of which had originally been transferred to her by decedent in preceding years.

The trust instruments were prepared by one of decedent's employees in accordance with a plan devised by decedent to create additional trusts before the advent of a new gift tax expected to be enacted the next year. Decedent selected the properties to be included in each trust. Janet Grace, acting in accordance with this plan, executed her trust instrument at decedent's request.

Janet Grace died in 1937. The Joseph Grace trust terminated at her death. Her estate's federal estate tax return disclosed the Janet Grace trust and reported it as a nontaxable transfer by Janet Grace. The Commissioner asserted that the Janet and Joseph Grace trusts were "reciprocal" and asserted a deficiency to the extent of mutual value. Compromises on unrelated issues resulted in 55% of the smaller of the two trusts, the Janet Grace trust, being included in her gross estate.

Joseph Grace died in 1950. The federal estate tax return disclosed both trusts. The Joseph Grace trust was reported as a nontaxable transfer and the Janet Grace trust was reported as a trust under which decedent held a limited power of appointment. Neither trust was included in decedent's gross estate.

The Commissioner determined that the Joseph and Janet Grace trusts were "reciprocal" and included the the amount of the Janet Grace trust in decedent's gross estate. A deficiency in the amount of $363,500.97, plus interest, was assessed and paid.

II.

Section 811 (c)(1)(B) of the Internal Revenue Code of 1939 provided that certain transferred property in which a decedent retained a life interest was to be included in his gross estate.[*] The general purpose of the statute was to include in a decedent's gross estate transfers that are essentially testamentary—*i. e.*, transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime. See *Commissioner* v. *Estate of Church*, 335 U. S. 632, 643-644 (1949).

The doctrine of reciprocal trusts was formulated in response to attempts to draft instruments which seemingly avoid the literal terms of § 811 (c)(1)(B), while still leaving the decedent the lifetime enjoyment of his property.[2] The doctrine dates from *Lehman* v. *Commissioner*, 109 F. 2d 99 (C. A. 2d Cir.), cert. denied, 310 U. S. 637 (1940). In *Lehman*, decedent and his brother owned equal shares in certain stocks and bonds. Each brother placed his interest in trust for the other's benefit for life, with remainder to the life tenant's issue. Each brother also gave the other the right to withdraw $150,000 of the principal. If the brothers had each reserved the right to withdraw $150,000 from the trust that each had created, the trusts would have been includible in their gross estates as interests of which each had made a transfer with a power to revoke. When one of the brothers died, his estate argued that neither trust was includible because the decedent did not have a power over a trust which he had created.

The Second Circuit disagreed. That court ruled that the effect of the transfers was the same as if the decedent

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[2] See Colgan & Molloy, Converse Trusts—The Rise and Fall of a Tax Avoidance Device, 3 Tax. L. Rev. 271 (1948).

had transferred his stock in trust for himself, remainder to his issue, and had reserved the right to withdraw $150,000. The court reasoned:

> "The fact that the trusts were reciprocated or 'crossed' is a trifle, quite lacking in practical or legal significance. . . . The law searches out the reality and is not concerned with form." 109 F. 2d, at 100.

The court ruled that the decisive point was that each brother caused the other to make a transfer by establishing his own trust.

The doctrine of reciprocal trusts has been applied numerous times since the *Lehman* decision.[3] It received congressional approval in § 6 of the Technical Changes Act of 1949, c. 720, 63 Stat. 893.[4] The present case is, however, this Court's first examination of the doctrine.

The Court of Claims was divided over the requirements for application of the doctrine to the situation of this case. Relying on some language in *Lehman* and certain other Courts of Appeals' decisions,[5] the majority held that the crucial factor was whether the decedent had established his trust as consideration for the establishment of the trust of which he was a beneficiary. The court ruled that decedent had not established his trust as a *quid pro quo* for the Janet Grace trust, and that Janet Grace had not established her trust in exchange for the Joseph Grace trust. Rather, the trusts were found to be part

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[3] See, *e. g., Glaser* v. *United States,* 306 F. 2d 57 (C. A. 7th Cir. 1962); *Estate of Moreno* v. *Commissioner,* 260 F. 2d 389 (C. A. 8th Cir. 1958); *Hanauer's Estate* v. *Commissioner,* 149 F. 2d 857 (C. A. 2d Cir.), cert. denied, 326 U. S. 770 (1945); *Cole's Estate* v. *Commissioner,* 140 F. 2d 636 (C. A. 8th Cir. 1944).

[4] See S. Rep. No. 831, 81st Cong., 1st Sess., 5–6 (1949); H. R. Rep. No. 920, 81st Cong., 1st Sess., 5 (1949).

[5] See *McLain* v. *Jarecki,* 232 F. 2d 211 (C. A. 7th Cir. 1956); *Newberry's Estate* v. *Commissioner,* 201 F. 2d 874 (C. A. 3d Cir. 1953); *In re Lueder's Estate,* 164 F. 2d 128 (C. A. 3d Cir. 1947).

of an established pattern of family giving, with neither party desiring to obtain property from the other. Indeed, the court found that Janet Grace had created her trust because decedent requested that she do so. It therefore found the reciprocal trust doctrine inapplicable.

The court recognized that certain cases had established a slightly different test for reciprocity.[6] Those cases inferred consideration from the establishment of two similar trusts at about the same time. The court held that any inference of consideration was rebutted by the evidence in the case, particularly the lack of any evidence of an estate tax avoidance motive on the part of the Graces. In contrast, the dissent felt that the majority's approach placed entirely too much weight on subjective intent. Once it was established that the trusts were interrelated, the dissent felt that the subjective intent of the parties in establishing the trusts should become irrelevant. The relevant factor was whether the trusts created by the settlors placed each other in approximately the same objective economic position as they would have been in if each had created his own trust with himself, rather than the other, as life beneficiary.

We agree with the dissent that the approach of the Court of Claims majority places too much emphasis on the subjective intent of the parties in creating the trusts and for that reason hinders proper application of the federal estate tax laws. It is true that there is language in *Lehman* and other cases that would seem to support the majority's approach. It is also true that the results in some of those cases arguably support the decision below.[7] Nevertheless, we think that these cases are not in accord with this Court's prior decisions interpreting related provisions of the federal estate tax laws.

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[6] *E. g., Orvis* v. *Higgins*, 180 F. 2d 537 (C. A. 2d Cir.), cert. denied, 340 U. S. 810 (1950).

[7] See cases cited in n. 5, *supra*.

Emphasis on the subjective intent of the parties in creating the trusts, particularly when those parties are members of the same family unit, creates substantial obstacles to the proper application of the federal estate tax laws. As this Court said in *Estate of Spiegel v. Commissioner*, 335 U. S. 701, 705-706 (1949):

> "Any requirement . . . [of] a post-death attempt to probe the settlor's thought in regard to the transfer, would partially impair the effectiveness of . . . [section 811 (c)] as an instrument to frustrate estate tax evasions."

We agree that "the taxability of a trust corpus . . . does not hinge on a settlor's motives, but depends upon the nature and operative effect of the trust transfer." *Id.*, 335 U. S., at 705. See also *Commissioner v. Estate of Church, supra.*

We think these observations have particular weight when applied to the reciprocal trust situation. First, inquiries into subjective intent, especially in interfamily transfers, are particularly perilous. The present case illustrates that it is, practically speaking, impossible to determine after the death of the parties what they had in mind in creating trusts over 30 years earlier. Second, there is a high probability that such a trust arrangement was indeed created for tax-avoidance purposes. And, even if there was no estate-tax-avoidance motive, the settlor in a very real and objective sense did retain an economic interest while purporting to give away his property.[8] Finally, it is unrealistic to assume that the settlors of the trusts, usually members of one family unit,

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[8] For example, in the present case decedent ostensibly devised the trust plan to avoid an imminent federal gift tax. Instead of establishing trusts for the present benefit of his children, he chose an arrangement under which he and his wife retained present enjoyment of the property and under which the property would pass to their children without imposition of either estate or gift tax.

will have created their trusts as a bargained-for exchange for the other trust. "Consideration," in the traditional legal sense, simply does not normally enter into such interfamily transfers.[9]

For these reasons, we hold that application of the reciprocal trust doctrine is not dependent upon a finding that each trust was created as a *quid pro quo* for the other. Such a "consideration" requirement necessarily involves a difficult inquiry into the subjective intent of the settlors. Nor do we think it necessary to prove the existence of a tax-avoidance motive. As we have said above, standards of this sort, which rely on subjective factors, are rarely workable under the federal estate tax laws. Rather, we hold that application of the reciprocal trust doctrine requires only that the trusts be interrelated, and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries.[10]

Applying this test to the present case, we think it clear that the value of the Janet Grace trust fund must be included in decedent's estate for federal estate tax purposes. It is undisputed that the two trusts are interrelated. They are substantially identical in terms and were created at approximately the same time. Indeed, they were part of a single transaction designed and carried out by decedent. It is also clear that the trans-

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[9] The present case is probably typical in this regard. Janet Grace created her trust because decedent requested that she do so; it was in no real sense a bargained-for *quid pro quo* for his trust. See also *Hanauer's Estate* v. *Commissioner, supra,* n. 3.

[10] We do not mean to say that the existence of "consideration," in the traditional legal sense of a bargained-for exchange, can never be relevant. In certain cases, inquiries into the settlor's reasons for creating the trusts may be helpful in establishing the requisite link between the two trusts. We only hold that a finding of a bargained-for consideration is not necessary to establish reciprocity.

fers in trust left each party, to the extent of mutual value, in the same objective economic position as before. Indeed, it appears, as would be expected in transfers between husband and wife, that the effective position of each party *vis-à-vis* the property did not change at all. It is no answer that the transferred properties were different in character. For purposes of the estate tax, we think that economic value is the only workable criterion. Joseph Grace's estate remained undiminished to the extent of the value of his wife's trust and the value of his estate must accordingly be increased by the value of that trust.

The judgment of the Court of Claims is reversed and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

MR. JUSTICE STEWART took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES

No. 574.—October Term, 1968.

United States, Petitioner, *v.* Estate of Joseph P. Grace, Deceased, et al.	On Writ of Certiorari to the United States Court of Claims.

[June 2, 1969.]

Mr. Justice Douglas, dissenting.

The object of a reciprocal trust, as I understand it, is for each settlor to rid himself of all taxable power over the corpus by exchanging taxable powers with the other settlor. Yet Joseph P. Grace and his wife did not exchange taxable powers. Each retained a sufficient power over the corpus to require the inclusion of the corpus in his or her taxable estate. Each settlor, as one of the three trustees, reserved the right to alter the trust by paying to the chief beneficiary "any amounts of the principal of the said trust, up to and including the whole thereof, which the said Trustees or a majority of them may at any time or from time-to-time in their sole discretion deem advisable." I have quoted from Janet Grace's trust. But an identical provision is in the trust of Joseph P. Grace.

I would conclude from the existence of this reserved power* that the corpus of the Janet Grace trust was

*The relevant provision of the 1939 Internal Revenue Code (§ 811 (d)(2)) is practically identical with the corresponding provision of the 1954 Code (26 U. S. C. § 2038 (a)(2)). Each provides that a decedent's gross estate shall include property—

"To the extent of any interest therein of which the decedent has at any time made a transfer . . . where the enjoyment therefore thereof was subject at the date of his death to any change through

includable in her estate for purposes of the estate tax. *Lober* v. *United States*, 346 U. S. 335.

That is to say the use of a reciprocal trust device to aid the avoidance of an estate tax is simply not presented by this case.

I would dismiss the petition as improvidently granted.

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the exercise of a power . . . by the decedent alone *or by the decedent in conjunction with any other person* . . . to alter, amend, or revoke . . . ."
The provisions of the Joseph and Janet Grace trusts would seem to satisfy that test, for only two out of the three trustees were necessary to alter the trust. See *Helvering* v. *City Bank Co.*, 296 U. S. 85.